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# COMPETITION IN TRANSPORTATION

## POLICY AND LEGISLATION IN REVIEW

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VOLUME I

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**NATIONAL TRANSPORTATION  
ACT REVIEW COMMISSION**

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VOLUME I

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NATIONAL TRANSPORTATION  
ACT REVIEW COMMISSION

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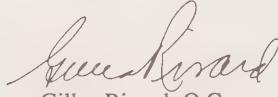
Commission d'examen de la  
Loi sur les transports nationaux

TO THE HONOURABLE  
MINISTER OF TRANSPORT

Dear Minister:

We, the Commissioners, appointed by Order in Council P.C. 1992-176 dated January 31, 1992, have the honour to submit to you, pursuant to section 266 of the *National Transportation Act, 1987*, the report of the National Transportation Act Review Commission.

Respectfully submitted,



Gilles Rivard, Q.C.  
Chairman



Clay Gilson  
Commissioner



Frank Edward Collins  
Commissioner



John Gratwick  
Commissioner



Horst Sander  
Commissioner

January 1993





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## Preface

For most of us, the first intimation of a remarkable experience came with a disembodied voice on the telephone — an Ottawa official asking if we were willing to be considered for a panel to review the *National Transportation Act, 1987*. Who we are inevitably affects our perception of issues, but none of us chose to represent any group or region. We felt from the beginning that our autonomy was a great strength and we guarded it carefully. It was an undoubtedly benefit that we came from different regions and walks of life, but it did not restrict our debate.

In the year that followed we were given a unique opportunity to see the world's second largest nation through the prism of a pervasive economic activity. Events which unfolded in 1992 demonstrated the vital need to adapt to change. The North American Free Trade Agreement was negotiated. Canada's two largest airlines recorded serious losses, proposed a merger, then opted for international alliances. CP Rail announced its plan to exit Atlantic Canada, then, with Canadian National Railways, made an unprecedented agreement to share common trackage. Transportation is called a "derived" industry. Because it exists to serve other industries and individuals, it reflects the larger economy, with all its strengths and weaknesses. We found ourselves learning about the larger commercial and political system.

We have travelled to every province and met hundreds of people. No one can do this and not become conscious of the personality of the country. Witnesses appearing before us ranged in occupation from entrepreneurs to academics, bureaucrats to municipal politicians and corporate leaders, but in total they represented a remarkably articulate, and thoughtful community.

From the beginning an important decision made our job easier and our final product better. We considered a variety of methods for consulting interested parties, and chose to advertise for written submissions, followed by individual consultations with invited groups in Ottawa and across the country.

These meetings generally occurred only after we had had a chance to study the written submissions. We did not conduct formal hearings, nor were our meetings adversarial.

The result of this program was a unique opportunity to make the best of each encounter, with the basic issues already explained, and the partisan positions understood. There was virtually no acrimony and none of the adversarial rigidity that can often characterize regulated industries.

Early in our consultations some groups expressed dismay that we had decided not to act as referees or judges in the familiar contests among interests. By the end of our consultations, we thought there was a higher level of satisfaction with the process chosen than there would have been with any other process. But, obviously, not everyone could meet with us. Some may be disappointed that their point of view did not carry the day. We sincerely hope that all participants felt that they had an opportunity to make their views understood.

A study of any subject as sprawling as Canadian transportation might have profitably occupied as many years as we had months. Without the assistance of many people, this work would not have been achieved. We are particularly grateful to those groups whose submissions reflected a great deal of thought, hard work and a sincere effort to contribute to an important national debate. It was not uncommon for groups to depart with requests for additional information or documentation which they obligingly forwarded.

We appreciate the efforts of National Transportation Agency and Transport Canada officials and staff who shared their experience and responded cheerfully and quickly even to some demanding requests. We found the same helpful attitude in other departments: the Bureau of Competition Policy, External Affairs and International Trade, Labour, Finance and Environment Canada.

Provincial governments also supplied us with some of our most important submissions, often commissioning research or analysis specifically

for our review. Strong representations by provincial delegations, which frequently included the Minister responsible, helped us to comprehend the public policy challenges.

Our efforts could not have been converted into a coherent report without the intensive work of our Commission Staff. Under the direction of our Executive Director, Warren Everson, experts in law, transportation, research, administration and consultation were brought together from across the country to complete this enormous task — George Heinmiller, Legal Counsel from Vancouver, British Columbia; Sheila-Marie Cook, Director of Administration and Finance from Canmore, Alberta; John Heads, Director of Research from Winnipeg, Manitoba; Norman Steinberg, Senior Advisor (Policy) and Lucinda Boucher, Director of Consultations from Ottawa, Ontario. We gratefully acknowledge their dedication and excellent work. However, the responsibility for conclusions and recommendations remains ours.

It is fashionable to characterize the commercial marketplace as a world of ruthless competition, and many people made it clear to us that their businesses afford them little room for error or inefficiency. But we also found most witnesses remarkably fair in their views, and willing to consider the goals of others. If co-operation between partners is a crucial factor in facing competition, Canadians are prepared to work together profitably. If the key to success in the global economy of the future lies in an ability to learn quickly and adjust to change, the people who offered us their time and insights seemed well equipped to meet the challenge.

What we found is a nation facing formidable challenges with less than its best potential effort. With respect to its educated citizens, its advanced technology and natural advantages, Canada is well equipped to compete. With respect to misinvestment, dysfunctional barriers between regions, the coherence of its policies, and its overall national purpose, Canada is less well equipped.

We hope that our work will help in this regard.





# 1

## Introduction

The *National Transportation Act, 1987 (NTA, 1987)*<sup>1</sup> is the cornerstone of the Government of Canada's strategy to develop a competitive transportation system serving the diverse needs of Canadian travellers and shippers.

Enacted August 28, 1987, the legislation's goal was to replace Canada's cumbersome — and expensive — reliance upon federal regulation of the transportation sector with decisions made in reaction to the marketplace. In effect, transportation decisions would be more governed by the needs and wants of shippers and travellers instead of by government officials and politicians.

At the time of the legislation's passage, the government believed it prudent to ensure that certain checks and balances remained in the system. One of those checks was a review, after five years, of the impact of the Act. We were appointed Members of the National Transportation Act Review Commission, according to the terms of section 266 of the *NTA, 1987*. Our mandate was to assess the impact of this Act over its first five years and the impact of related economic regulatory reforms affecting transportation; to evaluate the state of competition in Canada's transportation sector; to examine impending issues; and to determine whether the legislation is equipped to deal with present and future challenges.

This report is the result of our 12-month effort. We have developed recommendations which we believe are appropriate to restore the health and ensure the competitiveness of our nation's transportation system in its service to individual Canadians and Canadian businesses.

### HISTORY

In this effort we joined a long tradition. Canadians have invested enormous amounts of energy in the study of transportation issues — justly regarding it

as one of the most crucial elements of economic prosperity in a country which has, as one prime minister wryly noted, "too much geography."

Many of the questions we probed have intrigued and perplexed analysts since before Confederation and the goals of our modern policies are probably much the same as they were a century ago.

We noted with amusement, for example, that the first Royal Commission after Confederation was about transportation — an 1871 study "Respecting the Improvement of the Inland Navigation," chaired by Sir Hugh Allan.

Some of the comments of Sir Hugh and his contemporaries could almost be confused with submissions sent to our Commission in the spring of 1992:

*The contest for the supremacy of the carrying trade of the great West will be between New York, Montreal and Quebec. Nature has given the latter cities the advantages of position and route, and it now only depends on enterprise and capital to determine whether they shall be left behind in the competition for an enormous traffic....*

*In urging this policy of canal enlargement and extension upon the favourable consideration of the government, the Commissioners feel it is the one which will best stimulate the commercial development of the whole Dominion and bind all sections together in the bonds of mutual amity and interest.*

These two themes — the battle to compete successfully in an international context, and the power of transportation to unify a fragmented nation — are deeply imbedded in our national psyche.

Indeed, one of the most evocative artifacts of our national heritage is an aged photograph of a man with a hammer surrounded by solemn spectators; it is the moment before the Last Spike is driven, before the nation is

linked from sea to sea, before the disparate stirrings of a thousand small communities are suddenly fused into a single national economy. It was not by chance that the battle to complete a railroad was titled “The National Dream.” It was a seminal event in our history.

Today, though the technology is different, the challenge is the same. Our struggle today is to carve our place in the world economy, and it is as formidable a challenge as the battle to carve a nation out of the vast and hostile geography of this land.

As we travelled to every region of Canada, inescapable truths about our economic structure emerged and were reinforced. In world terms, Canada is thirty-first in population and seventh in output. This means our small population produces a disproportionately large volume of certain goods and services. We must trade and sell outside our country in order to maintain our standard of living. This can be done successfully only if we can offer our exported products at competitive prices. And efficient transportation is fundamental to keeping our products, and our country, competitive by world standards.

In coming decades, the challenge will be even greater, as Canadians confront sharply rising global competition. These new challenges come at a time when our governments have been seriously weakened by record levels of debt, the servicing of which drains huge amounts of productive capital. Thus Canadians face the additional and pressing challenge of ensuring that our transportation system remains an asset to our economy at a time of declining public sector resources. The dual goals of competitiveness and unity which have made our transportation industries so critically important to us remain Canada’s policy pillars. Yet, as was the case with our forebearers, we must determine how we can best continue to achieve those policy objectives so that we are not, in their words, “left behind in the competition for an enormous traffic.”

## WHERE WE ARE, AND WHERE WE ARE GOING

In our work we have looked at the past, examined the present, and peered into the future. We have assessed the impact of the *NTA, 1987* during its first years of implementation. We have also examined emerging issues and attempted to determine whether the legislation is equipped to deal with these future challenges.

We have examined the rationale for the legislation, and some of its implications. We have also studied the impact of similar, earlier reforms in the United States which might shed light on the Canadian experience. We have attempted to assess the impact of the legislation through several empirical measures, and evaluated the state of competition in Canada's transportation sector.

Our report probes the condition of the carrier industries and the challenges confronting them. It studies the impacts of the Act on environment, safety and labour-management relations. It looks at the role of governments, whose decisions regarding taxation, subsidies and infrastructure investment continue to influence levels of competitiveness, even after regulatory reform.

Finally, we examine the *NTA, 1987* legislation itself and the National Transportation Agency created as a result of the legislation. We provide our assessment of how effective the new legislation is, and offer our thoughts on whether further changes are required to meet the national goal of a healthy and competitive transportation sector.

As a Commission we found it difficult to study transportation in and of itself. After all, the demand for transportation derives from the myriad needs of the people and business it serves. These needs, in turn, are shaped by the larger economic and political forces affecting our country. In order to assess transportation policies, we found ourselves considering the Canadian economy as a whole, and the government's economic policy framework for the nation. We came away from our study convinced that, just as no living being can exist without a network of veins and arteries to carry its lifeblood,

the economic health of our country cannot be sustained without a healthy transportation system.

### WHY WE HAVE THIS ACT

The underlying rationale for Canada's new transportation policy was stated clearly in the federal government's 1985 White Paper *Freedom to Move*.

"As the transportation sector matures," noted the White Paper, "regulation should be relaxed and simplified to allow the system to respond to the changing needs of shippers and the travelling public."

Consistent with this view, the *NTA, 1987* placed the transportation sector at the disposal of the rest of the economy. The demands of a market economy — the demands of shippers and their customers — would establish the appropriate levels of transport service, cost, profitability and mode. The essential features of the new legislation involved new freedoms for users and suppliers alike: freedom to contract privately with a carrier, freedom to enter into and, in most cases, to exit a business market.

This policy was a major change for Canada. As we have seen, all protected industries assemble powerful constituencies around themselves — labour unions, bureaucracies, dependent communities, and suppliers, among other groups. Such was the case with Canada's regulated transportation regime. Specific constituencies had reaped advantage from a system which limited competition and restricted rate negotiation.

Regulation was originally intended as an instrument to protect, to develop and to balance various interests. However, as the Canadian economy has matured and changed to meet new world conditions, so too have the needs and interests of shippers and travellers and those employed in transportation and associated industries. Today we know that our transportation industries cannot be protected from domestic and international competitive pressures without paying a heavy price elsewhere in our economy, and at the cost of undermining of our export industries. Nor can government balance the marketplace as once it could, because the most powerful forces affecting Canadian prosperity are beyond our borders.

This realization has profound implications for much more than just transportation in Canada. Our political culture has tended to be shaped for the benefit of specific regions or groups. Often these policies have come with price tags which we have generally accepted as an essential or defining part of "being Canadian." However, these additional costs are not so readily accepted by customers in the global marketplace.

Earlier transportation policy sought to balance the advantages of carriers with those of their clients. Prior to regulatory reform, Canadian carriers were protected to varying degrees from competition. This policy was rejected by the *NTA, 1987*. The new policy determined that such a balance was not a public responsibility or in the public interest. The quality and price of a transportation service should determine the success of the provider of that service.

### ENHANCING COMPETITIVENESS

The *NTA, 1987* did not emerge from a policy vacuum. In 1985 the Royal Commission on the Economic Union and Development Prospects for Canada warned that our nation showed telling signs of serious economic malaise and was increasingly vulnerable to unfavourable global economic trends. These concerns will be no less important during the remainder of this decade.

The *NTA, 1987* emerged as one element of the government's subsequent strategy to enhance national competitiveness. The resulting government economic program has included a series of trade liberalization initiatives, including the Canada/U.S. Free Trade Agreement; active participation in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT); and the negotiation of the North American Free Trade Agreement (NAFTA). Similarly, the federal government emphasized the need for public debt reduction and the privatization of certain Crown Corporations no longer serving a public policy role.

In addition, the government launched initiatives to reform the Canadian tax system and introduced measures to reduce economic regulation in other sectors of the economy. The *Competition Act* revisions of 1986 were

designed to deter anti-competitive actions and allow smaller companies to compete fairly with larger firms so consumers could enjoy competitive prices and wider choices.

Without necessarily endorsing any of these economic prescriptions individually, we noted that the federal government's diagnosis and prescription were generally accepted by most carriers and suppliers who made representations to this Commission.

### EFFICIENCY VERSUS DECLINE

Trade accounts for more than one-quarter of Canada's gross domestic product (GDP). That, and the overwhelming importance of maintaining our markets overseas, while also ensuring Canadian companies can compete effectively at home, are the best explanation for the government's preoccupation with competitiveness.

Those producing nations which successfully meet the stringent market demands and consumer expectations of the 1990s are those that will prosper in the years ahead. Clearly, Canada is given no more guarantee of future prosperity than any other nation. While world trade has increased substantially over recent years, the Canadian share has slipped from 4.5% in 1985 to 3.8% in 1990 — the steepest relative decline of any G-7 nation.<sup>2</sup>

A primary reason for this slide has been the decline in average commodity prices for raw and semi-processed materials which currently account for some 33% of Canada's exports. The International Monetary Fund, in its 1992 *World Economic Outlook*, notes that the average world price on non-fuel commodities fell by approximately 13% in 1990 and 1991.<sup>3</sup>

Equally disturbing is the extended decline of the average real world price for a basket of key Canadian commodity products. It has dropped *by half* since 1980 and shows few signs of recovery.<sup>4</sup> It is not surprising, therefore, that our economic strategies are heavily influenced by world commodity prices.

At the same time, troubling levels of public debt hinder governments' ability to strengthen the economy. Total government debt service costs are

approaching 10% of GDP. In 1981, total public sector debt was 33.5% of Canada's GDP. By 1991, it had risen to approximately 76% of GDP. The constraints imposed by the resulting high debt service costs severely limit government participation in future competitiveness-enhancing investments.

The government's regulatory reform initiative, exemplified by the *NTA, 1987*, is just one component of an extensive national economic liberalization program, which itself is a response to worldwide economic restructuring. It is against this compelling backdrop of lowered earnings and rising international and domestic competition that we considered the *NTA, 1987* and the important change it has brought to the role of government.

### THE COST OF EFFICIENCY

It is one thing to say efficiency must be increased, another to pretend that it does not carry painful consequences.

Prior to regulatory reforms of 1987, Canadian carriers were protected to varying degrees from competition. The *National Transportation Act* of 1967 permitted some competition between transportation modes, but limited competition *within each* mode. Inevitably, Canadians paid more for transportation services under this regime than would have been the case in a more open and competitive environment. As a result, it was to be expected that exposure to full-fledged competition would increase financial pressures on many firms accustomed to a regulated environment.

A hard recession combined with the growth of new operators has brought financial distress to many carrier industries. Air carriers have suffered record losses; Canada's two "Class I" railways (Canadian National Railways and CP Rail) have suffered severe revenue declines; and few motor carrier operators are profitable. Although it is impossible to isolate deregulation's impact from the recession, there is no denying that the situation of many carriers is grave.

It is also clear, however, that the liberalizing influence of the *NTA, 1987* has meant expanded freedom of entry for new operators in some modes and enhanced choices for consumers. By removing the protection

accorded the carriers, the *NTA, 1987* has allowed consumer choice to shape the industry's prices and services. For some corporate consumers of transportation services, their choice may be determined in larger measure by the criteria of international competitiveness than by domestic market conditions.

### THE “PRICE TAKERS”

As we consider how best to adjust to new economic forces, we should remember that these forces do not represent a sinister phenomenon, or one which is thrust upon an unwilling Canada. As one trade academic has written:

*With...interdependence has come great wealth. Goods are produced where their costs are the lowest. Consumers have more choices. Institutions of production are disciplined through competition. Producers can realize the advantages of economies of scale. But with interdependence has also come vulnerability. National economies do not stand alone. Economic forces move rapidly across borders to influence other societies.... economic interdependence creates great difficulties for national governments.<sup>5</sup>*

Canada has chosen to expand its trade, to earn profits abroad and to accept both the benefits of international trade and the concomitant challenges of international competition.

In the past, Canada's domestic economic policies often were designed to defy international pressures, to shield our population from harsh competitive realities. But in a globalized economy, nations which trade for prosperity cannot at the same time isolate themselves from the international community. Here we encountered one of the most difficult and significant issues in our exercise. Many Canadians describe regional development policies as unique and crucial to Canada's national identity. Yet such policies carry costs which cannot easily be passed on to customers outside Canada.

Again and again we heard the phrase: "Canadians are no longer price makers, as we were for decades after World War II — now we are price takers." And as price takers, who are subject to what the international marketplace will pay for Canadian goods, we are constrained in our capacity to impose policy goals which add cost to the products we sell abroad.

This cold reality presents a quandary for policy-makers, one in which Canadian values and priorities must be reconciled with inexorable international forces. We were reminded of how the House of Commons Standing Committee on Transportation struggled with the implications of this reality for one such Canadian preoccupation, regional development.

*We are aware that Confederation is sometimes worth the candle. Regular air services to an outlying community might be inefficient and economically unsound in a perfectly working marketplace — but nonetheless politically appropriate. However, we believe such decisions should be made openly, as the political decisions they are, with open subsidies and no hidden costs to distort the transportation system.<sup>6</sup>*

We believe that there are a number of areas in which this model would be appropriate and would help clarify costs and benefits.

We also note that Parliament, having debated the paradoxes of some of our non-economic national values, still saw fit to approve the central dictum of section 3 of the *NTA, 1987*, that: "...making the best use of all available modes of transportation at the lowest total cost is essential to serve the transportation needs of shippers and travellers and to maintain the economic well-being and growth of Canada."

### A FLAG ON THE TAIL

Do these "available modes of transportation" really need to be owned by Canadians in order to serve Canadian national objectives?

Many of those who appeared before our Commission expressed their concern that a vigorous east-west transportation network is essential to protect the integrity of the Canadian economy and to provide an alternative to a dependency on U.S. facilities and operators. Others advised us that the United States would use such a dependence as a mechanism of leverage over Canadian industry.

Representatives of some Canadian port operations and other infrastructure facilities argued that the loss of business across the Canada/U.S. border already threatened their long-term success and, in turn, would deny important competitive choices to Canadian shippers in the future.

Meanwhile, Statistics Canada data make it clear that major trade shifts are already under way. Canada's merchandise trade with the U.S. has increased by 10.7% in the three years since the implementation of the Free Trade Agreement (FTA). Exports of Canadian end-products to the U.S. have grown by \$4.0 billion since 1988.

Virtually every shipper who appeared before our Commission told us that they could not afford to incur any additional costs for the benefit of using a Canadian carrier.

The Canadian Pulp and Paper Association told us,

*We would prefer to have our transport carriers run by Canadians. However, we are in an extremely competitive industry and because of the nature of our industry (that is, the need to respond to global competition), we must have access to the most efficient carriers regardless of nationality.*

The Canadian Chemical Producers' Association declared,

*The companies that serve us should face the same kind of commercial circumstances as we do.*

Do these comments signal an end to Canada's economic independence? Will we be forced to choose between Canadian carriers and success as exporters? We generally concluded that the country can have it both ways.

Canada can benefit from its proximity to a vast market, without surrendering cultural and social autonomy, but only by meeting, as a nation, the challenge of world competition.

Threats to our sovereignty in the 1990s will be more severe in the form of economic weakness; policies which force shippers or travellers to use inefficient Canadian services will not help us meet that challenge. However, if the Canadian service is low-cost and reliable, it will not only serve domestic needs, but also might create the opportunity to attract business away from competitors in the United States.

### CHANGING RESPONSIBILITY OF GOVERNMENT

No one can seriously examine Canadian transportation without acknowledging the dominant role played by the federal government in designing policies to achieve the dual goals of national competitiveness and unity.

Although the *NTA, 1987* altered the role of government as a direct manager of the commercial marketplace, it had the effect of placing new emphasis on the federal government's role in certain other respects. Some examples include the maintenance of safety standards, provision of infrastructure, and the balancing of its interventions (i.e., taxes, subsidies and infrastructure investments) among modes.

The most obvious consequence of regulatory reform was considerable growth in the number of operators and/or the number of services available. We could find no clear evidence demonstrating that safety has suffered in this changed environment, though we have noted areas requiring careful attention. However, it is clear that the level of government-provided services has diminished relative to market size.

Under a regulated system, the government could maintain an equilibrium between commercial operations, federal capital spending and the provision of services such as air and marine navigation, operator licensing,

and carrier inspection. This equilibrium could not be sustained with regulatory reform. We also note that the kinds of investments made by governments in capital infrastructure often represent long-term or permanent commitments and costs. This is true for roads, ports and airport facilities, but in a manner of speaking it is also true for the "human infrastructure" of technical experts of all kinds. Air traffic controllers, vehicle inspectors, marine pilots and dozens of other specialists represent large investments which cannot be easily "downsized" when markets decline, nor instantly expanded in boom years.

Specific solutions are unique to each mode but, generally, the problem is related directly to the solution. It is the dynamism of the private sector that creates the pressure. Government can either restrain growth, which would be counterproductive in a competitive global marketplace, or it can use the private sector to set and finance the necessary levels of service. A mechanism must exist to link the need and value of service to the supplier. In fact, a mechanism is available in a system of cost recovery that includes an appropriate user oversight role. The need for "user pay, user say" systems is discussed in Chapter 6.

### THE UNCOMMON MARKET

Perhaps the most disappointing aspect of our Commission was the lack of national consensus we encountered, not just on transportation issues, but toward economic issues generally.

From its birth Canada was intended to be a common market. Section 121 of the *Constitution Act, 1867* provides that:

*All Articles of growth, produce or manufacture of any one of the provinces shall...be admitted free in each of the other Provinces.*

Despite these original intentions, we were disturbed by the amount of damage Canadians do to their economy through deliberate and often short-

sighted policies of internal protectionism and regional parochialism. In fact the Canadian Manufacturers' Association has estimated that internal barriers to trade cost the national economy in excess of \$6 billion per year.<sup>7</sup>

Contradictory or restrictive policies in the transportation sector have been put in place to favour particular regions, without respect for the national imperative. These measures carry a staggering cost to Canada as a whole. Policies which fragment the marketplace in a relatively small nation, holding neighbouring provinces or regions at bay while expanding our trade southward, are extremely destructive. In a country such as Canada, with a small population and an immense geography, such fragmentary policies are a flirtation with disaster.

We will neither succeed economically nor have a capacity to face future national challenges if we insist on remaining a divided, "balkanized" collection of regions.

Our report comments on the federal and provincial governments' effort to work together toward common goals, bearing in mind that such an effort is a prerequisite to economic prosperity.

### **HUMAN CAPITAL**

One of the greatest challenges for Canada's economy will be its ability to adapt to the emerging reality of transnational organizations. In the volatile world of the transnational corporations there is no tie to particular geographic sites. Global managers have one overriding responsibility — to enhance the company's global scale efficiency and competitiveness — and in that pursuit they are out to capture the full benefit of integrated worldwide operations.

Traditionally countries and individual firms prospered if they enjoyed the advantages of having more capital, superior technology and better skills than their competitors. New forces have emerged in the global market which are radically altering the traditional sources of competitive advantage. With the emergence of the transnational organizations, natural resources, capital and new technologies are moving rapidly around the world. In the

years to come the education and skills of the workforce will become *the* dominant competitive weapon.

Accompanying this trend is a massive change in the societal structures that support individual Canadians as they adjust to the ever-faster rate of economic and industrial change. The decline of traditional institutions has perhaps strengthened our desire to have governments protect national and social values through our economic policies.

We believe that government, educators, industry and labour share important responsibilities for preparing the Canadian workforce to meet the challenges of globalization and helping it adjust during the period of transition. This would include a collaborative labour-business commitment to retraining and skills upgrading and the financial support of governments to ensure that work force productivity remains a national priority.

In reviewing the impact of *NTA, 1987*, we recognized that, while governments cannot stall the rate of economic change, the individual citizen is, in the end, the prime "Canadian" element of a global economy. It is our "human capital" that Canada must develop and to which the government must target an increasing amount of its energies and resources.

### MAKING PROGRESS

A wealthy, technologically advanced nation such as Canada can probably absorb change with greater ease than less advantaged nations. Yet, even in Canada, the prospect of change creates inevitable unease — even while, intellectually, we may accept the need for change.

We are not alone in our unease. Just as those who worked the canal barges of the 1800s were threatened by the inevitable advance of the railroad, and wooden ships were displaced by steam, even the most beneficial development can seem threatening.

The dramatic changes in transportation must be acknowledged. The industry will change even more in future years, responding to technological improvements, shifting trade patterns, human creativity and, ultimately, the needs of users. The intervention of government, especially governments with

limited budgets, is unlikely to advance national economic competitiveness. Rather, we fear that such efforts to re-establish an interventionist system would inhibit positive economic forces and restrict Canada's progress.

It was for good reason then that the architects of the *NTA, 1987* emphasized the need for *freedom* to move.

---

The following New Year's message was sent by the Governor of New York State to the President in 1829

*Our nation's system of canals is threatened by the proliferation of a new type of transportation called the "railway".*

*The federal administration must protect the canals for the following reasons:*

1. *If ship transportation via canals is supplanted by the "railway", many will lose their jobs: captains, cooks, conductors, stableboys, lock repairmen and operators will all be unable to earn a living.*
2. *Shipbuilders as well as suppliers of tugs, whips, and harnesses will also be unemployed.*
3. *The ships in the Canal system are absolutely essential to the defense of the United States. In case of a conflict with England, the Erie canal would be the only transportation route for those supplies which are indispensable for war in our day and age.*

*For the above reasons, the government ought to create an Interstate Commerce Commission whose goal would be to protect the American people from the threat*

*posed by the “railway” and to preserve the canal system for posterity.*

*Mr. President, you undoubtedly are aware that these railway cars are propelled at the insane speed of 15 miles per hour by “engines”, which, in addition to endangering the passengers’ lives, track through the countryside roaring and pulling, setting fire to crops, frightening flocks as well as women and children.*

*God surely never meant people to travel at such hellish speed.*

### OUR OVERALL CONCLUSIONS

One of the most poignant comments in Parliament’s deliberations on the *NTA, 1987* came from the Committee studying the *Freedom to Move* White Paper. “Like fire,” the Committee stated, “competition, should be the servant, not the master.”<sup>8</sup>

No comment could better summarize Canada’s ambiguous response to the challenge of competitiveness. Canadians want the benefits which competition can bring, and they understand that their country must perform in a competitive global environment. But Canadians still want reassurance that the government will not allow competition to become too harsh.

For decades, it was possible to “piggyback” various policy objectives on the shoulders of the transportation sector and the producing economy it serves. A host of industries and regions were assisted in this way. Today, however, worldwide competitive pressures make this strategy impossible. It is essential that we unbundle these different efforts and ensure that the wealth-producing sectors are performing at their maximum. Only in this way will these sectors earn for Canada the wealth we require to support our social commitments.

While we found that new and rising levels of competition have contributed to added pressures on carriers, we were unable to find situations in which the country, overall, would have been better off with the previous regulatory framework. Indeed, some operators are flourishing in the new environment.

Regulatory reform has been a particular success in relation to freight services used to move Canadian goods to domestic and foreign markets. Costs for shippers have declined as competitive options have been made available through multimodal competition and carrier innovation.

We also found that passenger services have been enhanced dramatically in the years since the *NTA, 1987*. Although Canadian consumers have not enjoyed the dramatic reductions in air fares seen in the United States, major improvements have been made in the frequency and types of service provided. Likewise, innovative fare offerings are now better tailored to meet customer demand. We also note that smaller communities have benefitted significantly from an increase in service frequency, despite some early concerns about the impact of the legislation on these communities.

In light of these considerations, we believe that the regulatory reforms contained in the *NTA, 1987* have been successful in achieving their established objectives. There can be no doubt that Canada's industrial base has benefitted from the reduction in cost and improvement in service that are directly attributable to the passage of the *NTA, 1987*. Where there have been difficulties in imposing competitive pressures on corporate structures not designed to be responsive, we believe that solutions are available, and we offer policy and legislative proposals.

Canada's continued high quality of living depends on our ability to compete successfully in the world economy. Policy makers should be driven by the need for efficiency and responsiveness to the client in the transportation sector. Factors which inhibit the movement of goods and people within the country or between Canada and our neighbours should be subject to intense and sceptical scrutiny.

The withdrawal of government from direct management of the transportation section, and from the business of balancing economic interests through regulation, is a timely and appropriate policy. It is consistent with an overall economic agenda which recognizes the realities of Canada's struggle to retain its competitive position in a global economy.

We conclude that the regulatory reforms contained in the *NTA, 1987*, while subject to ongoing and continuous refinement, are the correct responses to this country's economic needs and the constructive role that transportation must play in securing a prosperous and united future for Canada.

#### NOTES

- 1 R.S.C. 1985 (3rd Supp) c.28 as amended R.S.C. 1985 (4th Supp) c.19., S.C. 1992 c.21.
- 2 GATT, International Trade, Geneva, 1985 and 1990. Value of export merchandise trade measured in U.S. dollars.
- 3 International Monetary Fund, *1992 World Economic Outlook*. Figures are in U.S. dollars, amounting to 8% and 5% in the years 1990 and 1991, respectively.
- 4 Canada. Department of Finance. Budget Papers. February 25, 1992, p.27.
- 5 Jackson, John, *The World Trading System: Law and Policy of International Economic Relations*. Cambridge, Mass., MIT Press, 1989, p.3.
- 6 *Freedom to Move: Change, Choice, Challenge*. 6th Report. Standing Committee on Transport. December 1985, p.4.
- 7 *Canada 1993: A Plan for the Creation of a Single Economic Market in Canada*. CMA Bulletin on Interprovincial Trade Barriers. April 1991.
- 8 *Freedom to Move: Change, Choice, Challenge*. 6th Report. Standing Committee on Transport. December 1985, p.4.





## 2

# Impacts

### INTRODUCTION

When the federal government adopted the *National Transportation Act*, 1987, it was in recognition that the primary forces shaping this service industry should not be governments, as had generally been the case, but, instead, the marketplace choices of the consumers — travellers and shippers — whose needs the transportation is supposed to serve. The objective of these regulatory reforms was to reduce the influence of government and greatly expand the influence of those consumers, thereby improving both service and competitiveness, and contributing to Canadian economic prosperity.

The new legislation represents a major step along a continuum of change dating back to the original *National Transportation Act* of 1967. In this chapter, we measure the impact of the legislation on the travelling public and shippers, in general, and on Canadians with disabilities in particular.

Our principal conclusion, after the past 12 months of consultation and investigation, is that the Act has had a positive impact on Canadian shippers and travellers, leaving them better off than they would have been without regulatory reform. In this chapter, we conclude that the Act neither created nor contributed to negative consequences for these key user groups.

Thunder Bay Harbour  
Commission

*"The Act has redefined competition in the Canadian transportation sector and there can be no doubt that shippers have been the net beneficiaries."*

### THE IMPACT OF REFORM — SHIPPERS

In the five years since the *NTA, 1987* was adopted, the rapid pace of change in the global trading environment has, if anything, accelerated. National economies are more and more open to international trade arrangements. Sovereign jurisdictions everywhere feel the effects of an increasingly interdependent world economy.

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M. Porter, Canada at the  
Crossroads: The Reality of a  
New Competitive Environment,  
October 1991

*"Deregulation is also paving  
the way toward lower prices  
and improved service for  
thousands of Canadian shippers  
in a variety of goods-  
producing industries. The  
international competitive-  
ness of Canada's industries  
is being strengthened under  
deregulation."*

---

surveys, when coupled with the comments and submissions of those with whom we consulted, provide a reliable picture of the impact of the legislative changes on Canadian shippers.

At the outset of this section, it is also helpful to consider the real world context in which Canadian shippers operate.

In a highly competitive trading environment, logistics management, or the ability to co-ordinate the efficient movement and placement of goods, is an important key to business success. The most effective logistics systems

are capable of responding to customer needs by ensuring consistent, on-time delivery of products to specified locations at the lowest possible cost.

Transportation is a major element in most logistics systems. In Canada, it is often the largest single cost factor. But a number of other trends have had a major influence on the cost and effectiveness of logistics systems.

As transportation costs have decreased, it has become profitable to ship goods greater distances. Many companies now use *focused factories* to produce or process specialized products or components for the North American market. These products are, in turn, shipped to other specialized factories for further product assembly.

*Network consolidation* has resulted in the downsizing or elimination of the string of warehouse companies formerly maintained across the country in favour of more centralized operations. Time compression and inventory elimination have been major factors behind this rationalization of distribution facilities.

Shippers have also reduced the number of transport suppliers. For-hire truckers can now serve broader geographical areas and as a result shippers no longer have to fragment shipments among several carriers.

Shippers have also become more selective in choosing carriers. Cost is no longer the only focus in negotiation. Shippers give more attention to the trade-off between price and service.

Additionally, electronic data interchange (EDI) is slowly being integrated into Canadian operations as shippers put pressure on carriers to monitor shipments electronically in order to further improve logistics management.

For many Canadian manufacturers, however, technological advances and the emergence of a continental market also mean that logistics decisions, for example, the choices of carrier, are frequently made using a continental perspective. Increasingly, those decisions are being taken by managers based outside Canada.

When we spoke to shippers about those factors which they considered most important in meeting their transportation needs, they frequently

described freight rates and reliable, on-time delivery as two crucial elements which influence the success of their operations. They also mentioned many other factors, including total transit time, door-to-door service and cargo protection.

There is nothing static about Canada's transportation sector. The change sweeping the industry is driven by forces both within and outside Canada. The opportunity that lies before the country is to work with those forces to Canada's maximum advantage.

### **Effects — Some General Assessments**

The *NTA, 1987* proposed a number of changes which were designed to improve the competitive position of Canadians shippers at home and abroad. We wanted to know if the legislation had the intended effect.

In submissions before our Commission and in survey interviews conducted on our behalf we found that shippers generally took a positive view of the changes made to the regulatory environment by the new legislation. Many felt that the Act encouraged cost-effective and efficient transportation. They generally agreed that it had provided both shippers and carriers with the stimulus they needed to become more competitive. But the shippers were also candid in placing that impact in perspective. In our September survey, we asked shippers to rank the impact of nine separate factors on their operations. The new transportation legislation was ranked sixth. From the perspective of shippers, more important factors were the general health of the economy, labour and energy costs, taxation, and environmental and safety laws.

The majority of shippers to whom we spoke also indicated that their logistics strategy would not have been substantially affected had there been no reform of the transportation regulations. However, many of these same individuals also stressed that, without regulatory reform, many primary and basic manufacturing companies would be in far worse condition today than they are. Several told us that the competitive, lower cost environment that resulted from the *NTA, 1987* had enabled their industries to penetrate new and more distant markets.

While representatives of the shipper community have described the overall impact of the legislative changes as positive, how did they view those changes when it came time to consider the Act's impact on each individual transportation mode?

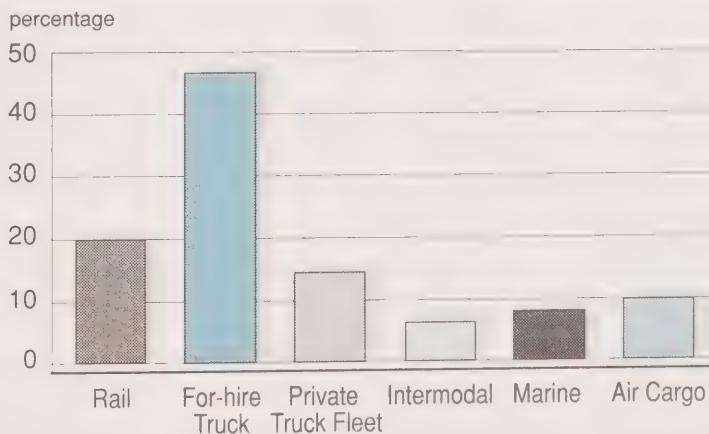
### Impacts on Shippers by Mode

In considering the impact on shippers of the changes made to the regulatory environment, it is important to know that the trucking industry is the transportation mode most often used by shippers. In fact, trucking completely dominates all other transportation modes, including intermodal transport, in terms of the freight bills paid by industry. (See Figure 2.1.)

Novacor Chemicals Limited

*"We have experienced a real improvement in rail and highway transportation services and cost competitiveness since the introduction of the National Transportation Act, 1987."*

**Figure 2.1**  
**Percentage of Freight Bill Assigned to Each Mode, 1992**



SOURCE: Peat Marwick Stevenson & Kellogg

### *Trucking*

What impact has the *NTA, 1987* had on shippers' use of the trucking industry to move goods?

In our study, we found that a consensus emerged on the nature of that impact. Shippers generally believe they have benefitted from the effect of regulatory reform on the trucking industry. However, while they may have been pleased with the overall impact of the changes, they expressed concern about the lack of uniformity in the rules governing vehicle dimensions and truck safety between the various provinces. This, combined with the inconsistency in the application of regulations by the provinces, resulted in higher costs, according to many shippers.

What indications did we find that there had been improvement? A number of examples help illustrate the finding.

Earlier in this report we mentioned the changing dynamic involved in the selection of carriers by shippers. Cost no longer automatically dominates the negotiation process, but instead there is careful scrutiny of the trade-off between price and service. When shippers were asked to consider the impact of the reforms in this area, their view, once again, was positive.

For example, in the 1991 survey conducted by the National Transportation Agency, shippers expressed general satisfaction with the improved quality of service offered by for-hire services, involving both truckload (TL) and less-than-truckload (LTL) carriers. Interestingly, even the least efficient service factors associated with these two carrier categories, such as claims handling and tracing of shipments, were given favourable ratings by the shippers who responded to the 1991 survey.

Our research also indicated that both TL and LTL price increases have been held well below inflation since 1987 and that, in real terms, the cost of truck transportation has decreased for most shippers.

The new legislation introduced reduced entry controls on extra-provincial trucking. While only a small number of shippers participating in the 1991 survey felt that this new measure had an impact on their operations, the majority of these firms described the change as beneficial.

### *Rail*

What measurable impact did the *NTA, 1987* have on shippers who used or relied upon the Canadian railways to move their goods?

After 12 months of consultation and review, it is clear that shippers were especially enthusiastic about the impact of one particular change introduced by the 1987 Act. The use of confidential contracts as a mechanism for agreeing on freight rates has proven to be very popular and effective.

The *NTA, 1987* contains a number of additional devices intended to encourage competition, such as competitive line rates (CLR), final offer arbitration, public investigation and mediation. However, while these devices appear to be well regarded, we saw little evidence that they were being broadly used, although shippers claim that they are important bargaining tools.

The National Transportation Agency data indicate that most of the shippers doing business with the railways used confidential contracts. Shippers told us that their principal objective in negotiating confidential contracts was to secure rate concessions and guarantees against rate escalation.

While many shippers considered the confidential contract rates to be higher in 1991 than the previous year, they still found them lower than alternative published tariffs.

For shippers, the most positive service factors included the railways' ability to trace cars, the time required for transit, and the overall quality and efficiency of the service. Paradoxically, the weakest features from the shippers' perspective also included transit time and overall efficiency.

In responding to the Commission's survey of September 1992, many shippers expressed concern about whether the benefits of the *NTA, 1987* would be maintained. They noted the need for railways to have greater flexibility in cost management and particularly to be given greater latitude to shed unproductive lines through abandonment or transfers to short line operators, but worried about the impact on themselves.

### *Marine Transport*

The impact of *NTA, 1987* on shippers utilizing marine transport is not as easily identified as in other modes.

There has been a general increase in the level of competition generated by non-conference carriers and a subsequent decrease in the importance of shipping conferences. However, the impact of the new legislative provisions intended to encourage further competition, such as confidential service contracts, has been marginal.

Chamber of Shipping of  
British Columbia

*"Canada has benefitted greatly from its policy of open opportunity for vessels of any flag to trade in its exports and imports. Fierce competition has led to favourable freight rates, whether they be offered by tramping bulk carriers, conference or non conference scheduled services."*

year earlier. However, current freight rates are lower overall than those in the previous decade.

We also encountered a somewhat negative view of the *Shipping Conferences Exemption Act (SCEA)*, which we discuss in more detail later in the report. However, the debate on this issue was inconclusive, as evidenced by the comments of those who appeared before us and by survey results. While more than one-quarter of the shippers who responded to the 1991 National Transportation Agency survey felt that the *SCEA* should be

eliminated, still others wanted the legislation modified to limit the power of the conferences.

We found that many shippers lack a clear understanding of the objectives of the legislation and its effect, if any, on the international shipping market.

### *Air Freight*

Air freight services account for a very small percentage of the average shipper's freight bill. Nonetheless, air freight was used by almost 50% of the shippers surveyed by the National Transportation Agency to meet some portion of their transportation needs.

On service quality the views of shippers are mixed. One-third of the shippers canvassed in the Commission survey of September 1992 reported service improvements; one-third indicated no change; and the remainder had no opinion or felt service levels had deteriorated since 1987.

Those reporting improvements found them in the overall service quality, available capacity and carrier reliability. The greatest deterioration was noted in the number of direct flights available and the erosion of available carrying capacity.

We also found concerns expressed about the decline in air freight capacity to smaller centres, particularly in Atlantic Canada. Communities such as Stephenville, Newfoundland, now find themselves at a disadvantage. Turbo-prop service associated with the hub-and-spoke system has replaced the former jet aircraft. Similar concerns were expressed to us respecting communities in New Brunswick and Northern Ontario. Unfortunately the turbo-props have a much smaller cargo capacity than larger jets and this, in effect, represents a diminution in cargo service to the community.

### *Intermodal Services*

Intermodal services offer the most promising area for new growth in the transportation services sector. Over 50% of the shippers who responded to the Agency's survey in 1991 indicated they had used intermodal services that year. A large number of these shippers believed that the quality of service had

improved over previous years. They especially noted improvements in carrier co-operation, the overall quality of service, and service reliability.

As with the other transportation modes discussed in this section, more shippers using domestic or international intermodal services experienced freight cost increases than decreases or "no change." However, shippers using transborder services generally found that their costs did not change.

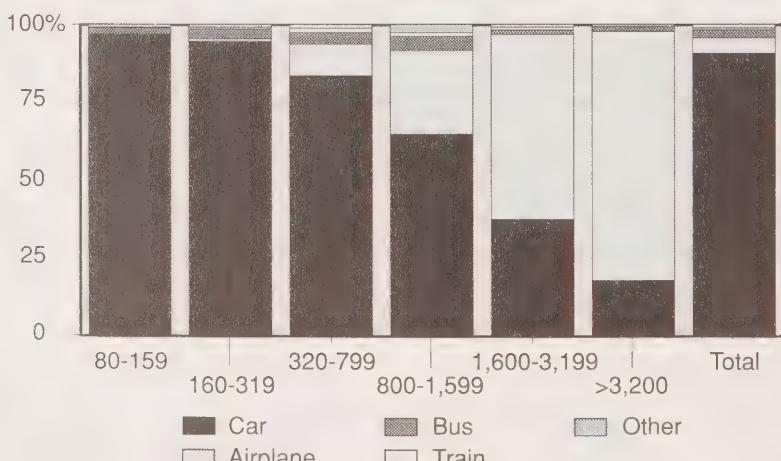
### THE IMPACT OF REFORM — TRAVELLERS

In this section, we examine data that help provide us with a measure of the legislation's impact on the travelling public. However, before we consider those impacts, it is important to acknowledge briefly the role played by the private automobile in passenger transportation.

For the general public, the private automobile represents the most frequently used mode of transportation. (See Figure 2.2.)

**Figure 2.2**  
**Domestic Intercity Travel by Mode and Trip Length, 1990**

One-way trip length in kilometres



SOURCE: Unpublished data from Statistics Canada's Canadian Travel Survey.

However, regulation and control of the private automobile is largely a provincial responsibility and is not covered by the *NTA, 1987*. As a result, the study of this form of passenger transportation was beyond the scope of our mandate. In addition, the Royal Commission on National Passenger Transportation, whose report was tabled in the House of Commons on November 19, 1992, focused considerable attention on this aspect of passenger transport, as well as buses and passenger trains.

As a consequence, we have focused our review on that other primary mode of passenger transportation which is federally regulated and most directly affected by the *NTA, 1987* — air transportation.

In examining the impact of the new legislation on the travelling public, we also looked at the special circumstances of disabled travellers. In 1987, 1988 and 1992, federal legislators incorporated specific provisions in the new Act to improve access to transportation for persons with disabilities. Our comments on this issue, in this section of the report, while general in scope, refer only to federally regulated transportation modes.

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Federation of Canadian  
Municipalities

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*“Personal mobility is critical  
to the nation’s well being  
and prosperity.”*

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### Travel by Air

Regulatory reform of the Canadian air industry gathered momentum with policy changes announced in early 1984. Subsequently, these and other changes designed to reduce regulation and encourage reliance on market forces were incorporated into the *NTA, 1987*. However, the new legislation also acknowledged the special situation of Canada’s northern and remote communities, as illustrated in Figure 2.3, together with the role government has chosen to play in ensuring that the transportation needs of those communities are met. As a result, the National Transportation Agency, which was a product of the 1987 Act, retains a greater degree of regulatory control over a designated

area of northern Canada than it has in managing its responsibilities in southern Canada. (See Figure 2.3.)

**Figure 2.3**  
**Delineation of Northern and Southern Routes**  
**for Licence Purposes**



SOURCE: National Transportation Agency

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Air Transat

*"The minimization of the regulatory burden on air carriers has created benefits for the consumer and Canadian communities."*

September 1992 survey and information from the Agency's 1991 survey.

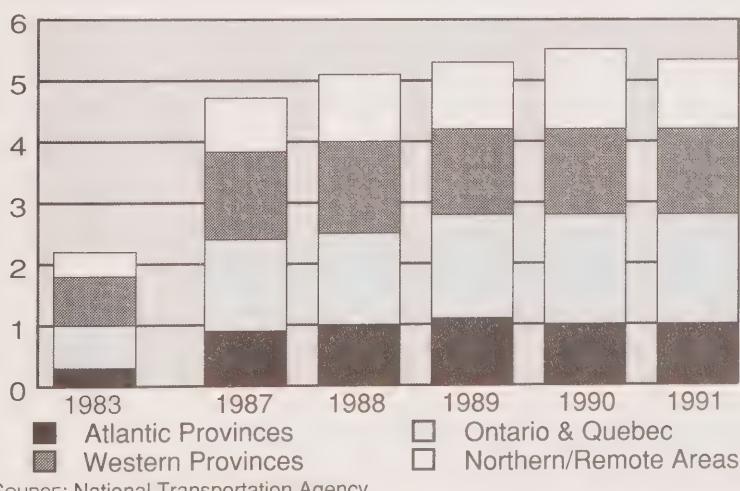
### Air Service

In the post-reform environment, the most obvious evidence of change to air service was the growing number of scheduled flights crisscrossing the regions of Canada.

Data submitted to the Commission clearly indicate that the number of scheduled flights in all regions of the country has increased substantially compared with the pre-regulatory reform period. For example, in 1991 there were over twice as many weekly scheduled flights as there were in 1983. (See Figure 2.4.)

**Figure 2.4**  
**Weekly Scheduled Flights in Canadian Regional Markets**

Thousands in Third Quarter



During our hearings, representatives of the Air Transport Association of Canada and provincial officials from New Brunswick cited the air-link between Charlottetown and Halifax as an example of the trend toward

increased availability of flights and seats. Prior to the regulatory reforms of 1987, the route had been served exclusively by Eastern Provincial Airlines utilizing two Boeing 737 flights per weekday. The total passenger capacity each way was 218 seats.

The service available in 1992 is very different. Currently there are two regional carriers serving the route. They offer 12 Dash 8 flights per weekday, with a total passenger capacity of 444 seats each way.

Since 1987, Canadian air carriers have moved to introduce a variety of service innovations in their effort to attract and hold customers. The government-mandated introduction of "no smoking flights" has become so popular that it is a service feature being copied around the world. On-board telephones, advanced boarding passes, valet parking, private lounges equipped for business communications, and special centres to care for travellers with particular needs (such as unaccompanied children, the elderly, and persons with disabilities) are examples of service improvements introduced by Canadian carriers in the brief period since regulatory reform.

What about the attitude of travellers themselves? In our September 1992 survey respondents were asked to compare the quality of air service in 1983 with the current service. They were asked to include the impact of discounted air fares in their assessment. Of those non-business travellers who responded to the survey, some 35% felt air service was better while 37% found it to be about the same.

Conversely, when the National Transportation Agency surveyed business travellers on the same issue in 1991, only 12% felt service had improved and 34% said service had deteriorated since 1983.

In a report submitted to us, the National Transportation Agency concluded that

*travellers have access to more flights and more frequent service than prior to 1988 because regional affiliate networks have expanded, acquiring routes previously served by the*

*larger carriers, and they have expanded into previously under-served local markets.*

While we agree with this overall assessment of an improved service environment, there are service drawbacks associated with these changes. For instance, travellers from smaller centres are often required to make connecting flights through hubs and they must often travel in smaller aircraft to reach those hubs.

The Charlottetown-Halifax air route demonstrates the benefits and drawbacks of regulatory reform. While it is now much easier to get to Halifax from Charlottetown, there are no longer direct flights from Charlottetown to, for example, Ottawa.

On balance, however, we believe that the data indicate that travellers seeking to reach smaller communities are better served now, in terms of schedules and options, than they were prior to regulatory reform.

— The travelling public has also benefitted from the impacts of regulatory reform on the Canadian charter services sector. In 1992 the capacity in the Canadian charter industry was much greater than it was in the mid-1980s. The industry has experienced strong competition in fare levels and has improved its level of service to the travelling public.

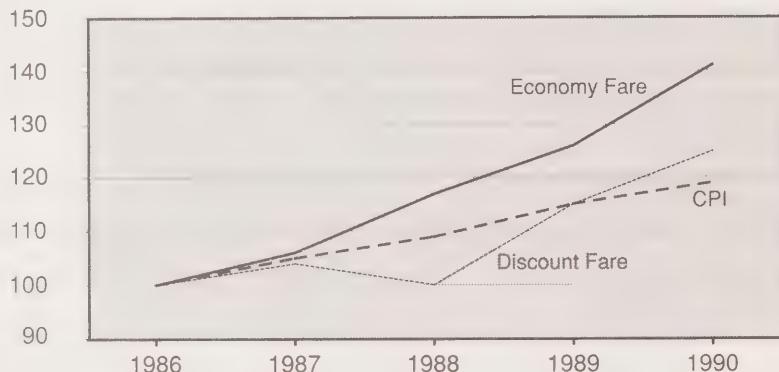
#### *Air Fares*

Data taken from the Commission's September 1992 survey of non-business air travellers suggest that Canadians are well aware of the value and the availability of discounted fares. We note, however, that in the National Transportation Agency's 1991 survey, business travellers expressed dissatisfaction with the level of air fares. They felt that as travellers paying full fare, they were subsidizing discount travellers.

Air deregulation in the United States provoked significant declines in air fares. In Canada, the benefits of lower air fares have been less dramatic. Statistics Canada's "Fare Basis Survey" reports an increase between 1986 and 1990 in both the economy fare index (including business class) and the discount fare index for domestic scheduled services operated by Level I carriers.

**Figure 2.5**  
**Fare Index versus Consumer Price Index on**  
**Southern Canadian Routes, 1986-90**

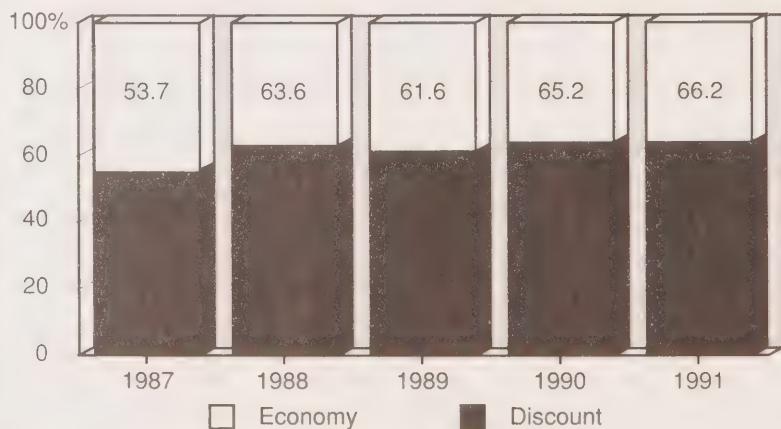
1986 = 100



SOURCE: Statistics Canada.

**Figure 2.6**  
**Discount versus Economy Fare Usage, 1987-91**

Percent Share in 2nd Quarter



SOURCE: National Transportation Agency.

The figures on the preceding page illustrate the nature of some the activity in air fares since 1987. In particular Figure 2.5 shows the economy fare index to have risen more than the consumer price index; however, this does not take into account the increased use of discounted fares. Figure 2.6 indicates that there has been an increase in the number of air travellers flying on discounted fares. In 1991, over 66% of passengers on domestic flights in southern Canada travelled on discounted fares.

### *The North*

Today, some 60 different air routes connect communities across northern Canada with each other and with the cities of southern Canada. In the last eight years, the level of activity along those routes has increased significantly. Despite a modest dip in the number of flights in 1990-1991, the overall number of flights available in the North grew by 111% between 1983 and 1991.

The mix of aircraft employed in the northern air service has also changed dramatically in that brief period of time. Jet flights in the region have increased by 12% since 1983, while the increase in non-jet flights has leapt by almost 630% during the same time.

While this increase in activity cannot be attributed exclusively to the implementation of the 1987 reforms, the Act did encourage the entry of new operators in this particular market.

### **PERSONS WITH DISABILITIES**

As Canada's population ages, the number of Canadians with disabilities will increase. Currently, some three million Canadians must cope with some form of disability, and approximately two million of these individuals have disabilities which affect their use of some type of transportation.

Social scientists have often described the damaging effects of social isolation. Disabilities can act as physical and mental barriers to contact and integration with the broader community. Transportation can play an important role in re-establishing that connection. For Canadians with disabilities,

full participation in society means having equal access to Canada's transportation systems.

While our report stresses the importance of the marketplace in shaping transportation decisions, we agree fully that it is the responsibility of government to play the lead role in breaking down barriers to access to transport facilities by Canadians with disabilities. This fact was recognized by the federal government when it drafted the *NTA, 1987*.

The new Act as amended makes specific references in section 3(1) to the importance of accessible transportation for individuals with disabilities.

Amendments made to the Act in 1988 (section 63.1 to 63.4) gave the National Transportation Agency responsibility for "eliminating undue obstacles in the transportation network governed by this Act to the mobility of disabled persons."

Interest groups representing persons with disabilities viewed the amended *NTA, 1987* as an important signal from the federal government that it intended to improve access to transportation services for those with disabilities.

When amended again in the spring of 1992, the Act further clarified the intention of making access to transportation for individuals with disabilities an essential objective of Canada's transportation system. Section 3(1) of the Act now reads:

*It is hereby declared that a safe, economic, efficient and adequate network of viable and effective transportation services accessible to persons with disabilities and making the best use of all available modes of transportation at the lowest total cost is essential to serve the transportation needs of shippers and travellers, including persons with disabilities....*

(emphasis added)

Canadian Human Rights  
Commission

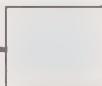
*“The Canadian Human Rights Act, the Canadian Charter of Rights and Freedoms, and the National Transportation Act all hold out the promise to Canadians with disabilities of a transportation system free from barriers. Despite these enactments, persons with disabilities still maintain that barriers in the transportation system remain one of the most persistent obstacles to their full integration in Canadian society.”*

sidy, could erode their competitive position and compromise safety.

From organizations representing persons with disabilities, we heard of frustration with the perceived slow pace of change. The Canadian Disability Rights Council (CDRC) called for an enhanced legislative and regulatory framework to promote improved accessibility. Their representatives urged the government to establish a timetable within which obstacles to accessibility would be identified and measures would be taken to remove them. The CDRC also suggested the establishment of an advisory committee on barriers and the creation of a public interest funding mechanism.

We acknowledge the frustration, which is understandable among organizations representing persons with disabilities. Progress has been slow. For example, it has taken five years for the federal government to publish,

though only for comment, two sets of regulations — one on procedures for aircraft with 30 or more passenger seats and the other on programs for training transport industry personnel.



#### **RECOMMENDATION NO. 1**

**We recommend that the federal Cabinet, under section 63.1 of the *NTA, 1987*, actively pursue the passage of regulations promoting access for persons with disabilities.**

While the pace of change has been slow on the regulatory side, we must also acknowledge that progress has occurred on a wide variety of other fronts.

The report of the Royal Commission on National Passenger Transportation identifies several initiatives taken by government agencies and departments, as well as by the transportation industry. While far from complete, there can be no doubt that access to transportation for Canadians with disabilities has improved since 1987.

When the federal government tabled 1992 amendments to federal legislation affecting the rights of the persons with disabilities, the Secretary of State for Canada indicated that our Commission would comment on the transportation proposals that have been submitted by the CDRC. We are pleased to do so.

In its proposals to the government, the CDRC underlined the lack of uniformity in extraprovincial busing regulations. We, too, want to see a reduction in the disparities across Canada in the way the issue of accessibility is handled by carriers.

The CDRC has suggested certain legislative amendments. We believe the interests of persons with disabilities would be best served by the proactive administration of existing legislative powers rather than legislative amendments suggesting absolute rights of access.

However, we believe that the federal government should pursue the general thrust of the CDRC's proposals. We believe that one way to accomplish this would be to enhance the mandate of the Minister's Advisory Committee on Accessible Transportation. This Committee, including representatives of people with physical and mental disabilities, as well as the transportation industry, could play an important consultative, interpretive and co-ordinating role.





# 3

## Impacts on Safety, Environment and Labour-Management Relations

### INTRODUCTION

In the previous chapter we sought to measure the impact of the *National Transportation Act, 1987* on key users of Canada's transportation system, the travelling public and shippers.

This chapter considers the impact of the *NTA, 1987* on a number of other important issues. They are: transportation safety, our physical environment and labour-management relations within the Canadian transportation industry.

During the consultative phase of our review we heard from many groups and individuals who either raised these issues specifically or alluded to them as part of a broader presentation to our Commission.

The Commission, having had the benefit of the submissions and advice of a broad array of intervenors, found that the new legislation is generally benign in its impact on public safety in most of the transportation modes, although careful attention should be directed toward the performance of some highway and small airline operators. We also found that the new Act may have had some impact on the environment, although it is difficult to separate the effect of the legislation from other factors. Finally we could find no evidence that the legislation has harmed labour-management relations, although it does influence the environment in which labour negotiations are conducted.

## TRANSPORTATION SAFETY

### Introduction

The policy and legislative context for our review is anchored in the 1985 federal White Paper, *Freedom To Move*. In that document the federal government said it would “neither propose nor permit any economic regulatory reform that might be detrimental to safety standards.”

Subsequently, when the *NTA, 1987* was adopted, federal legislators included in section 3(1) of the Act the stipulation that “a safe...network of viable and effective transportation services...is essential to serve the transportation needs of shippers and travellers.” Section 3(1)(a) of the Act declares that competition depends, in part, on Canada’s transportation system meeting “the highest practicable safety standards.”

Canadian Chemical Producers’  
Association

*“The record shows that  
transportation safety contin-  
ues to be a top priority in  
today’s deregulated  
environment.”*

Our review follows, by a few months, the release of the report prepared by the Commission of Inquiry into the Air Ontario accident at Dryden. In turn, our report will be followed in 1993-94 by a legislatively mandated review of the operation of the *Railway Safety Act*. A similar review will be conducted to examine the performance of the independent Transportation Safety Board (TSB). In addition, even as our Commission was carrying out its work, the Canadian Council of Motor Transport Administrators (CCMTA), a federal-provincial-territorial body, was attempting to finalize development of a common safety test for those firms seeking to enter the extraprovincial trucking market.

Given these circumstances, we decided not to initiate new research in the field. Rather, we analyzed the latest data available on safety performance in the various transportation modes. Much of the information we gathered came from, among other sources, the Transportation Safety Board, Transport Canada and the National Transportation Agency.

#### Did the *NTA, 1987* affect safety?

As our research report demonstrates, we found no evidence to suggest that there was a general deterioration in the level of safety as a result of the regulatory reforms of 1987. We will, however, comment upon some safety patterns that are notable in the air and truck modes, and on an aspect of the legislation affecting the railways which requires correction.

#### Air

Did the regulatory reforms of 1987 have an impact on air safety performance?

We were unable to find any causal connection between the regulatory reforms and a possible decline in safety performance in the airline industry.

Our examination of the issue, which is set out in Volume 2 of this report, noted no deterioration in the safety performance of Level I carriers such as Air Canada and Canadian Airlines International. However, we found that the number accidents involving Level II carriers has increased since the 1989-1991 period. We believe that Transport Canada needs to examine this situation and, if required, implement corrective measures. The industry and the department should also pay close attention to the safety record of other, lower-level carriers.

Considerable concern has also been expressed about the combined effects of the 1987 reforms and the budgetary cutbacks at Transport Canada. In his report on the Dryden air accident, and in his discussions with us, Justice Moshansky made clear that the department was not prepared for the demands placed on Canada's air transportation system by the post-reform industry. As the level of industry activity increased, the ratio of "officers to



### RECOMMENDATION NO. 2

**We recommend that the Minister of Transport direct departmental officials to investigate and determine the causes of the increased incidence of accidents involving air carriers other than Level I carriers, and take necessary corrective measures.**

"volumes" fell. We are aware of Transport Canada's efforts to respond to Justice Moshansky's recommendations. We are also aware of the economic dimension of this issue. The declining demand for air travel caused by the recession has helped to ease the problem somewhat.

However, the comments of Justice Moshansky and others we consulted suggest that resources alone will not solve the problems. Indeed, the size and organizational complexity of the Aviation Group of Transport Canada also pose a serious challenge for its departmental managers. We are aware that much work has been undertaken to improve the corporate culture and management structure of the Group. We believe these efforts are crucial if we are to ensure air safety.

We would also encourage a continuous review of the relative responsibilities of government agencies and private operators, in particular to ensure both operators and governments play their full roles in protecting public safety.

### Rail

Our research uncovered no data that would point to a general deterioration in rail safety. We found nothing to indicate that the regulatory reforms of 1987 had adversely affected the safety records of Canadian railways.



Quite apart from the *NTA, 1987*, some submissions to the Commission expressed concern about the apparent, and inadvertent, gap in present anti-trespass legislation, following the repeal of section 359 of the *Railway Act*.

The *Criminal Code*, which deals with issues of trespass, may not have provided adequate protection. Briefs from the major railways suggested the need for stiffer fines. In our view, fines, by themselves, are unlikely to lead to a reduction in trespassing, but where authority to control railway company property appears to be weak or absent, some modification to the law is warranted.



#### RECOMMENDATION NO. 3

**We recommend that an offence for trespassing on railway yards or tracks be again enacted.**

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#### Trucking

The number of fatalities caused by highway accidents in Canada has been in decline for many years. Fatalities associated with tractor-trailers have not changed since the new legislation was enacted in 1987. But the number of fatalities connected to the operation of straight trucks weighing in excess of five tonnes has increased. We could not discover the cause of this and we would encourage the industry and both the federal and provincial ministers of transport to pay attention to these developments.

Representatives from the shipper community, trucking interests and provincial regulatory agencies expressed strong concern to us about the effectiveness of truck safety regulations. A few suggested that as the trucking fleets age they could potentially pose a safety problem.



#### RECOMMENDATION NO. 4

We recommend that the Minister of Transport and provincial ministers responsible for trucking direct appropriate officials to investigate and determine the causes of the increased incidence of accidents involving straight trucks over five tonnes and take necessary corrective measures.

Many briefs cited the lack of a common safety code and the inconsistent application of the existing standards. Several submissions urged the federal government to assume responsibility for this issue, if the provinces fail to act.

This demand for action, however, is not made in a vacuum of government activity. Prior to passage of the *Motor Vehicle Transport Act* in 1987, the federal, provincial and territorial governments signed a Memorandum of Understanding, committing themselves to the development and implementation of a National Safety Code for Motor Carriers (NSC). Representatives of the various governments have been negotiating the substance of the code for many months now.

Several briefs, presented by representatives of the trucking industry, stressed their support for the uniform application, across all provinces, of clear national safety standards. They urged governments to enforce the NSC to prevent some operators from evading the rules while competitors bore the cost of compliance. If these rules are to be effective, they argued, then they must be enforced. It may be time for the federal government to re-assert its responsibility for enforcement — a responsibility it has delegated to the provinces with varying results.

Groups also focussed attention on the issue of a fitness test which would govern entry to the interprovincial trucking market. Most intervenors

wanted a more demanding test applied to new applicants. Some doubted that a fitness test consisting of a written examination completed by company officials would improve the carrier's attitude toward safety. There was no certainty that employees would be more conscious of safety regulations because the owner of their firm had passed a test.

The Canadian Trucking Association (CTA) considers the current fitness test to be ineffective. A meaningful test to ensure safety can be achieved, they argued, only through federal legislation to replace the variety of interpretations and implementation systems now in place in each province. In their view, maintaining the existing fitness requirements would be a "total abdication of responsibility by governments."

The CTA also suggested that a fitness test should include an examination of applicants' financial capacity to determine whether they have the ability to carry out the safety program they have promised to provide.

Provincial officials from Saskatchewan reported to us that the province's increased on-road checks had "greatly enhanced heavy truck safety." Yet the province also told us that, in 1991-92, 40% of the heavy trucks which were examined through this program had defects. This, in turn, was only a slight improvement from 1990-91.

The results, to date, of efforts to define a meaningful and practical fitness test are far from satisfactory. Past experience indicates that the process for achieving agreement among Canadian jurisdictions, and their subsequent implementation of regulatory change in trucking, is not only lengthy but produces imperfect results. We believe this to be unacceptable where the safety of all highway users may be compromised.

Unfortunately, with respect to extraprovincial trucking, the federal government has limited levers to oblige the provinces to move toward complete, and uniform implementation and enforcement of the NSC or to agree on other safety related matters. However, we believe that it is of sufficient importance that the federal government take every possible initiative to lead the provinces and territories to creating a safer environment on the highways.



### RECOMMENDATION NO. 5

We recommend that the Minister of Transport appoint a senior representative to chair a working group to resolve expeditiously the inconsistencies of regulation, interpretation and enforcement respecting safety aspects of extraprovincial trucking. In the event that implementation and enforcement of an acceptable standard of safety regulations, including the National Safety Code for Motor Carriers, have not been achieved by March 31, 1994, then the federal government, with respect to jurisdictions not in compliance, should withdraw the delegation to administer extraprovincial trucking regulation and/or withhold federal contributions to highway infrastructure.

### Marine

In our review, we noted that the regulatory reforms of the *NTA, 1987* have had little, if any, impact in the course of the safety of the marine mode.

### TRANSPORTATION AND THE ENVIRONMENT

The *NTA, 1987* does not deal with the physical environment. Instead, federal rules affecting the relationship between the environment and transportation are set out primarily in two statutes: the *Canadian Environmental Protection Act (CEPA)* and the *Canadian Environmental Assessment Act (CEAA)*.

The *CEPA* controls the use of new substances and the release of toxic substances, while the *CEAA* requires environmental impact assessments of projects affecting matters under federal jurisdiction.

Nonetheless, in a growing body of public commentary, as well as in significant court decisions, government has been urged to design policies with careful consideration to their environmental implications. While not specifically named in our mandate, environmental concerns are now frequently raised in transportation matters and were a part of submissions presented to us by some groups. For this reason, we have felt compelled to provide some views on the subject.

In examining the impact of the *NTA, 1987* on the environment, we considered several issues. First, what have been the environmental impacts of transportation since the introduction of regulatory reforms? Second, what is the effect of environmental regulation on the competitiveness of Canada's transportation system? Third, should the Act be amended to reinforce environmental protection?

Data available from many sources indicate that all the transportation modes contribute significantly to air pollution and global warming, through the emission of various compounds such as carbon monoxide and nitrous oxide. This is especially true of the trucking mode, which is also responsible, directly or indirectly, for most transport-related land-based oil and fuel spills. Additionally, the roadbed which supports this transportation mode also accounts for the greatest land use of all the modes.

The general effect of transportation on the environment varies depending on the impact of one of several factors, such as the overall level of activity across all modes, the types of shifts which may occur between modes, and the efficiency of transport systems employed and the efficiency of the technologies utilized.

We also found that substantial effects can result from relatively small shifts in transportation activity from one mode to another, and especially from rail to trucking.

However, it was very difficult to separate the impacts on the environment that could be attributed to the Act from those that would have occurred even without the Act. We were unable to find a reliable method which would allow us to quantify the effects of regulatory reform.

It is not clear, for example, to what extent regulatory reform contributed to the shift from rail to trucking. We cannot say it encouraged the shift since this trend was evident long before 1987. Nor can we say the reforms discouraged the shift to trucking. We can conclude, therefore, based on the data available, that the Act played a minor role among those factors leading to increased environmental impacts.

A more general concern involves the impact of Canada's environmental laws on the investment and operational decisions being made by the transportation industry. It seems clear that these laws will add to industry costs.

Of the two primary pieces of federal environmental legislation, we can expect the *CEAA* to have the greatest impact on Canada's transportation system, since an environmental review will have to be conducted before almost any transportation project can formally proceed. For example, a major highway development or an upgrading project that is supported with federal funds would require a full assessment before it could begin.

We are confident that Canada can have strict environmental protection without unnecessary delay and cost, but clearly this is not yet the case. We regard the efficiency of the current environmental review process as being a challenge which governments should confront immediately.

Additionally, the *CEPA* could add to the cost of transportation operations by introducing restrictions on fuels and additives, which may result in higher compliance costs.

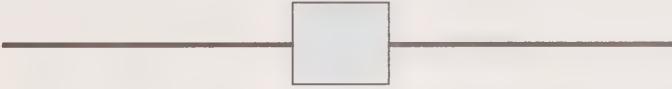
Environmental issues were not a prominent concern among most of those we consulted. However, some individuals were troubled that the Act was silent on the environment and they expressed a view that section 3 reflect the importance of the environment. Quebec's Transport Ministry, for instance, suggested that "environmentally sound" transportation services be stipulated as an objective in the Act's policy statement.

Since 1987, public debate has often touched on the link between the environment and transportation. For instance, while some parliamentarians have called for a more rigorous assessment of transportation impact on the

environment, still others have argued that rail service should be encouraged, because they believe it to be one of the most environmentally friendly modes of transportation.

It was against this background that we considered whether the Act should be amended to specifically reinforce environmental protection. Our view is that it should not be. We reasoned that the *CEPA* and the *CEAA* seem likely to address environmental impacts associated with most industries, including transportation, in an increasingly effective manner. Environmental laws are already in place. Additional legislation is not needed for the transport sector.

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#### **RECOMMENDATION NO. 6**

**We recommend that consideration of environmental matters not be addressed specifically in the *NTA, 1987* but rather continue to fall under environmental protection statutes of general application.**

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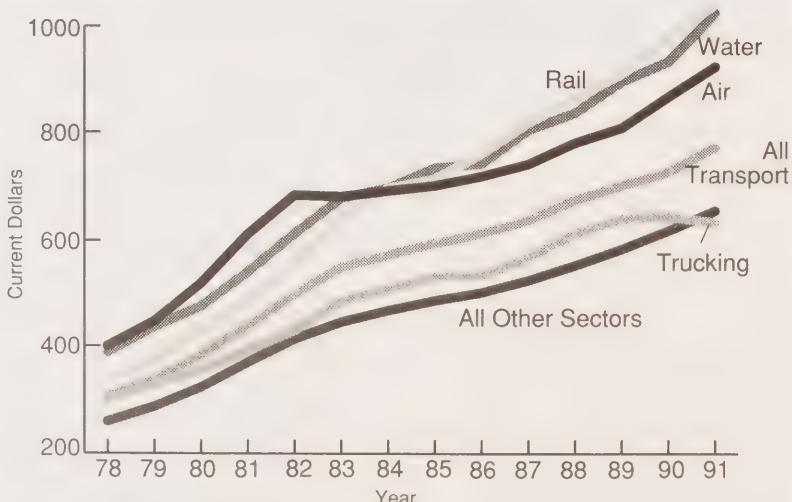
This approach will help ensure that there will be no conflict or confusion between transportation and environmental legislation.

#### **LABOUR-MANAGEMENT RELATIONS**

The climate has changed within which labour-management relations are played out in Canada's transport field. During our review, we examined labour-management relations in the three transportation modes most directly affected by the reforms of 1987 — air, rail, and trucking. While substantial changes have occurred over the past few years, the contribution of regulatory reform to these changes is difficult to gauge.

To the extent that it has encouraged heightened competition within and between modes, reform has increased pressures to reduce labour costs in order to improve or protect market share. However, the influence of the 1987 reforms is just one of many factors shaping the labour-management environment. Generally, the performance of key sectors of the economy (i.e., manufacturing and resources) has a critical influence on labour-management relations, as do technological changes and shifting trade patterns, including the effects of globalization and the Canada-U.S. Free Trade Agreement. The transport modes must also be sufficiently flexible to adjust speedily and effectively to meet the needs of shippers. They must be able to adapt to changing technological developments in the manufacturing and resource industries, and seize the opportunities for increased efficiency which flow from technological progress within the transport modes.

**Figure 3.1**  
**Average Weekly Earnings (\$)**



SOURCE: National Transportation Agency.

Employee compensation packages are good indicators of the state of labour-management relations, since they are normally a key element in contract negotiations. Transportation employees have been, and continue to be, well paid. Figure 3.1 provides information on the weekly earnings of transportation employees compared with the Canadian average. Rail workers are the highest paid. The average earnings for workers in the air, rail and marine industries are also substantially above the Canadian average.

In 1991, only workers in the trucking sectors slipped below the national transportation average. This result can be explained by intense competition within the industry, where entry into the industry has been facilitated by relaxed controls and capital costs for equipment are much lower than for air or rail. Trucking also has the lowest union penetration among the modes.

Work stoppages are also an important indicator of the quality of labour-management relations. Since regulatory reform, there has been no significant overall increase in strikes and lockouts. There were 47 strikes and lock-outs in the three-year period immediately preceding regulatory reform and 54 in the three years immediately following it. Strikes were least common in rail and most common in the trucking industry, despite low union participation in the trucking sector.





## 4

# The Carriers

This chapter examines the impact of the *National Transportation Act, 1987* on Canada's transport carriers. It is closely linked to Chapter 5, which deals with many of the same issues but from a singularly different — and not always complementary — perspective: the challenge of keeping competition alive.

The *NTA, 1987* represented a major change in government policy. Its regulatory reforms removed the carriers from being the dominant concern of government transportation policy to a very different position that stresses their role as a market-driven service industry whose own economic health is determined by the degree to which they can successfully meet the needs of shippers and travellers.

The sweeping reforms triggered by the *NTA, 1987* have been cited by some critics as the source of current structural and competitive pressures on the industry. Our consultations and research suggest that this assertion is inaccurate. In fact, the global recession, rather than regulatory reform, has been the single most significant factor affecting carriers. In addition, accelerating competition in North America, and indeed worldwide, has exerted a significant influence on the financial health of carriers.

### MODAL SHARES OF THE TRANSPORT MARKETS

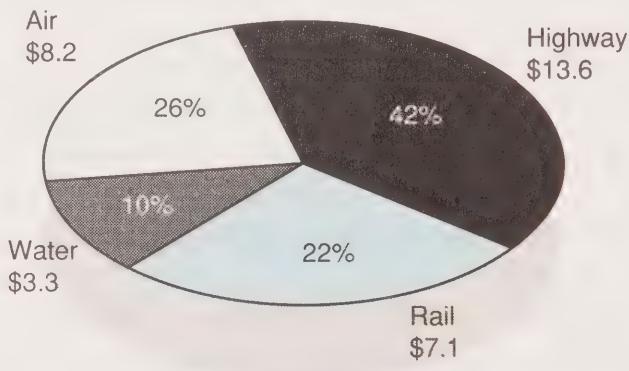
Carrier operating revenues provide a good measure of the relative importance of the different modes of transportation. In 1990, the total for the four modes — rail, highway, water and air — was \$32.2 billion.<sup>1</sup>

Highway carriers represent the most important transportation mode in terms of revenues generated, accounting for approximately 42% of all carrier operating revenues. Air carriers account for 26% of total operating

revenues, while rail represents a 22% share. The 10% of total revenues generated by marine transport reflects the absence of a Canadian deep-water merchant fleet.<sup>2</sup> (See Figure 4.1.)

**Figure 4.1**  
**Operating Revenues of Transport Carriers 1990**

\$ Billion and % Share

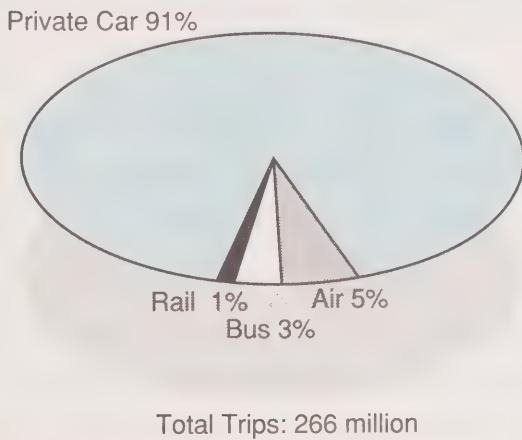


SOURCE: Statistics Canada

The private automobile dominates passenger travel in Canada. When the car is included in an assessment of total passenger trips, by mode, it swamps the figures generated by air, bus and rail — whose *combined* totals account for only 9% of all passenger trips. (See Figure 4.2.)

In 1990, passenger transportation accounted for 26% of combined operating revenues for all modes. Carriers in the air sector earned five-sixths of the total passenger revenues. In fact, 89% of total airline revenue was derived from passenger traffic.

**Figure 4.2**  
**Modal Shares of Intercity Passenger Trips, 1990**



SOURCE: Royal Commission on National Passenger Transportation

Conversely, passenger traffic generated just 9% of the rail mode's total operating revenue (including VIA Rail's government subsidy). Intercity bus services, the passenger carriers of the highway mode, accounted for less than 3% of the highway sector's operating revenues. In the marine mode, passenger ferry service was responsible for 6% of total operating revenues.

When it comes to the movement of freight, rail is favoured for long-distance shipping and trucks dominate the shorter hauls.<sup>3</sup> The volume of freight moved by air carriers is insignificant when compared with the absolute volumes moved by surface modes, but air freight is high value-added and expected to grow steadily in Canada and globally.

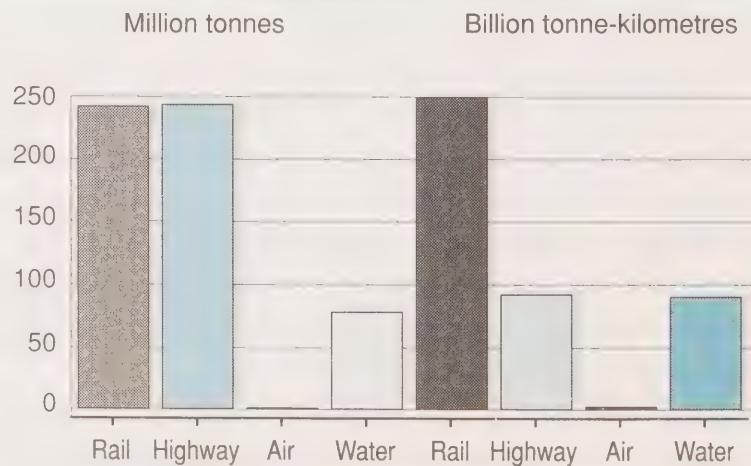
Commodities transported by rail are mainly primary products such as grain, metallic ores and forest products. Freight rates for these products are far lower than those applied to high-value manufactured goods that tend to move by truck.<sup>4</sup> This difference in the nature of truck and rail cargo

explains why highway operating revenues are much greater than railway revenues, as illustrated in Figure 4.1, despite the far higher figure of tonne-kilometres recorded for the rail mode in Figure 4.3.

Water transportation is important to a trading nation like Canada, but our overseas trade is generally carried on foreign vessels. The movement of domestic marine cargo within Canada on Canadian vessels totalled 77 million tonnes in 1990. This compares with 232 million tonnes of total cargo carried by water within Canada, between Canada and the United States and between Canada and overseas destinations.

Canada's international competitiveness is closely linked to rail because of that mode's contribution to bulk shipping. Canada's manufacturing industries rely mainly on the trucking industry to move their products, while rail plays a secondary role. Marine transport, while important to our trading capability in overseas markets, is dominated by foreign vessels. Air freight serves small but economically important niche markets.

**Figure 4.3**  
**Modal Transport of Freight, 1990**



SOURCE: Statistics Canada

## HIGHWAY CARRIERS

### Background

The trucking industry<sup>5</sup> has been affected by four major economic forces: recession, regulatory reform, U.S. carrier competition and structural changes affecting its customers.

### Effects of the *Motor Vehicle Transport Act, 1987*

A new approach to highway transportation was contained in the *Motor Vehicle Transport Act, 1987* and the measures it introduced to standardize truck weights and dimensions.

The *MVTA, 1987* directed provinces to abandon the existing, restrictive, entry test of "public convenience and necessity" which had previously been used to determine whether operators should be granted entry into the extraprovincial trucking industry. The new legislation substituted a "public interest" test. The test placed the onus on those individuals opposing a prospective licence to prove that the entry of the new operator would be detrimental to the public interest. This reverse-onus test was designed to apply for five years and then expire. It was to be replaced by a fitness test that would better meet the requirements of an industry making a gradual adjustment to open markets and greater market competition.

In many provinces — particularly Quebec, Ontario and Alberta — the reverse-onus entry test was interpreted as less restricted entry and, as a result, little time was allowed for marketplace adjustment. Relaxed rules of entry resulted in a flood of new entrants and an influx of U.S. carriers in transborder markets.

As most provinces also deregulated intraprovincial trucking, they found that competition increased. By the early 1990s, only British Columbia, Saskatchewan and Manitoba retained restrictive intraprovincial regimes. In 1991, responding to overcapacity in its trucking sector, Ontario imposed a two-year moratorium on new entrants to the intraprovincial market.

## Highway Carrier Concerns

### *Financial Performance*

To assess the health of the trucking industry, we considered the operating ratios generated by the sector. Operating ratios are the common standard of financial performance in the transport sector. They measure expenses as a percentage of revenues. For example, an operating ratio of 100 means that expenditures equal revenues and there is no return for interest payments or owner equity. Data from 1988 to 1991 show steady deterioration in operating ratios in this sector from 96.1 to 97.5. This trend has continued. As is common when regulatory structures are liberalized, some operators in the trucking sector experienced a gradual "de-capitalization" as the value of their licences diminished.

### *Regulatory Reform, Recession, U.S. Competition and Structural Change*

Recession is the key factor in the Canadian trucking industry's recent decline in profitability, and it echoes the earlier experience of the industry in the United States. The deregulation of the U.S. trucking industry in 1980 was followed by a recession in 1981-82. At that time, the U.S. industry witnessed failures among carriers whose pre-deregulation performance had been weak. Stronger carriers and new entrants moved quickly to meet the rising market demand which followed the recession.

Comparisons suggest that the U.S. industry is performing significantly better than the Canadian industry in the current recession. One possible explanation is that the management skills developed by the U.S. industry in the 1980s have enabled it to cope better with current economic conditions. Evidence suggests that the U.S. industry enjoys an advantage in deploying marginally superior techniques to manage factors ranging from human resources and general operations to pricing, marketing and quality and cost controls. But the difference may be attributed to experience rather than ability.

However, we must also take into account the structural change in Canada's industrial base and the shifts in distribution and trade patterns. Goods production and distribution are becoming more "global" in nature; North America is rapidly becoming a truly continental market. Some Canadian subsidiaries of both U.S. and multinational parents have experienced reduced autonomy in purchasing transportation services or selecting distribution networks. Contract negotiations and carrier selections are increasingly made by centralized distribution or logistics departments and not by the regional operations.

The North American Free Trade Agreement (NAFTA), if ratified, would accentuate this trend. It would create new demand for competitive transborder services and reduced need for transcontinental service.

The NAFTA's basic operating principle would allow the signatories to maintain their existing control mechanisms, such as market entry tests, but would require each government to treat all applicants for entry on an equivalent basis, regardless of nationality. For example, the Mexican government has agreed to harmonize international truck and bus services over the next 10 years. During the first phase of that transition, services in contiguous border states would be harmonized. By the seventh year, international trucking services could be offered throughout Mexico by Canadian and U.S. carriers. Finally, by year 10, there would be no restrictions on investments. The harmonization of technical standards would be completed by the year 2000.

### *Productivity and Employment*

Both the regulatory reforms of the *MVTA, 1987* and the provincial agreement on vehicle weight and dimension standards<sup>6</sup> have served to increase the productivity of the trucking industry. Research prepared for our Commission found

*... evidence from truckers on the Prairies suggest[ing] that truckload rates have not increased for some time and, further, that the introduction of new, more productive trucks has*

*something to do with this. Whatever the exact magnitude of the reduction, the point is that the transportation system received a significant boost to efficiency as a result of the 1988 agreement.<sup>7</sup>*

Another measure of trucking productivity is the incidence of empty truck movements. While information is limited, our consultations suggest that freer market access offers more opportunity for the development of triangular route patterns, which help avoid empty returns by trucks.

Employment in the trucking industry has traditionally risen and fallen with business cycles. We are satisfied from the available information that this pattern has not changed. Employment levels in the trucking industry appear to be much less related to regulatory reform than to the business cycle.

Although average weekly earnings in trucking are the lowest among all transport modes, in the second quarter of 1992 they were \$565, which is still 3% higher than the average for all industries.

#### *Concentration, Foreign Ownership and Business Failures*

We discovered little evidence of shifts toward or away from concentration and no indication that the *MVTA, 1987* has influenced these trends. We also found no evidence of major changes to foreign ownership.

Prior to regulatory reform, trucking firms were protected from competition through regulation. Bankruptcies were less frequent because operators could go out of business more quickly by selling their operating permits — their licence to participate in a government-regulated “closed shop.” Regulatory reform negated the value of these permits and, as a result, an increase in bankruptcies was expected to follow the reforms. The evidence as to whether this has happened is conflicting.<sup>8</sup>

### *The Fitness Test and Harmony in Regulation*

A poor financial performance is not the only serious concern of the industry. Industry representatives also expressed apprehension about the terms of the pending “fitness test” and the need for more regulatory harmony. In this regard, we support the Minister’s decision to allow the current reverse-onus entry provision to lapse.<sup>9</sup>

An associated issue concerning the reciprocity in regulations between provinces was raised. Carriers in “deregulated” intraprovincial markets complained that they were denied access to neighbouring “regulated” jurisdictions while carriers from those jurisdictions had access to their “deregulated” market. The complaints were centred primarily on the more restrictive entry controls enforced by Manitoba, Saskatchewan and British Columbia, but they also included criticisms of Ontario’s two-year licensing moratorium.

The trucking industry is concerned that its competitiveness may be undermined by government interventions in the marketplace that upset the harmony of regulations. Despite some progress, companies point to the fact that there continue to be problems with the lack of uniformity in regulations for vehicle size and weight, with the regulatory process itself and with the consistency of enforcement of the rules.<sup>10</sup> Industry representatives also spoke of the burden of multijurisdictional reporting involving licensing, fuel taxes and special permits.

We believe that these concerns must be viewed within the context of a national truck transportation system and the federal role in its regulation. The national process which produced these difficulties needs adjustment.

### **The Future**

The Canadian trucking industry has weathered difficult times over the last three years. Governments can help it resolve some of the problems it faces, but it is ultimately the industry’s responsibility to meet the new competitive challenges of the North American market.

Proceedings of the Third  
American Road Congress,  
1913

*"It is an idle dream to imagine that auto trucks and automobiles will take the place of railways in the long-distance movement of freight and passengers."*

Despite the financial difficulties faced by the industry, only one submission recommended a return to pre-1987 regulation. We believe that any such retreat would be highly inappropriate and would penalize those carriers who have already made market-place adjustments. Carrier survival will depend on a capacity to embrace the technology and management methods successfully used in the U.S. and currently employed by some Canadian operators. As noted in a study conducted for our Commission,

*There is no suggestion that U.S. trucking management is in any way "smarter" than Canadian trucking management. The differences are rooted in experience, rather than intelligence. There is no inherent, systemic or structural reason why U.S. management approaches cannot be imported with ease and applied in Canada.<sup>11</sup>*

We conclude that the performance of the Canadian trucking industry will improve with economic recovery.

Having said this, we are concerned that the lack of uniformity in trucking regulation impedes the efficiency of the industry and compromises our national ability to trade between provinces and with the United States.

**RECOMMENDATION NO. 7**

**We recommend that the Minister of Transport**

**negotiate with provincial governments to standardize operating and technical specifications affecting the trucking industry's efficiency. If such standardization can not be achieved by March 31, 1994, the Minister of Transport should introduce legislation providing for uniform operating and technical standards for extraprovincial trucking, to be administered by the provinces.**

**AIR CARRIERS**

Regulatory reform has revolutionized the air transportation market.

The *National Transportation Act, 1987* allowed freedom of entry, exit and rate setting in domestic airline services in Canada. But regulatory reform in the airline market really began three years earlier, with the New Canadian Air Policy of 1984.

In the eight years since, aviation has been the most turbulent of the transport modes. We believe that air transport constitutes the most complex problem facing Canadian transportation in this era of regulatory reform.

Canada's pre-reform market was characterized by less frequent, point-to-point service. It featured inflexible fare structures and services, and was dominated by Crown-owned Air Canada.

Today, customers enjoy far more frequency in flights — even on routes with low traffic volumes — flexible fare options and discount pricing and a range of service innovations. Competition exists, with a number of new entrants testing the market. Aggregate fare levels did not fall, but neither did

they match the increasing costs incurred by operators. For consumers, regulatory reform has been largely a success.

For the carriers, the era has been highly problematic. Airlines have changed as businesses, incorporating a range of innovations. Airline management today has a broad range of aircraft types in its fleets. They also manipulate "hub and spoke" route structures, which make use of an array of sophisticated marketing and business management tools: computer reservation systems, yield management programs, frequent flyer plans. International alliances ranging from equity swaps to code-sharing have been developed. The Canadian market has seen the privatization of the Crown carrier and the development of two dominant airline "families," each featuring a major scheduled carrier with a battery of regional feeders.

But the past eight years have been turbulent, and those that have survived have emerged from the 1980s with serious problems. Many of the independent scheduled operators are out of business, and by 1992 both major scheduled carriers were in dire financial straits.

### **Origin of the Problems**

In some respects many of the current problems are products of factors which were present in the market even before the reforms of 1984 to 1987. The size disparity between the two major carriers may have encouraged a desperate competitive struggle. Air Canada's dominance in terms of equipment and domestic and international routes forced any second carrier to choose between status as a secondary player or as a direct challenger to Air Canada in the entire market. With the 1987 acquisition of CP Air by PWA Corporation (PWA), it became clear that the newly formed company, Canadian Airlines International, was going to take the latter course. But with Air Canada already serving most routes, the presence of a new, fully national carrier ensured excessive capacity and tough competition in every market.

The de facto deregulation of 1984 was followed by a number of good years for the Canadian economy and for the major air carriers, which were generally profitable between 1984 and 1987. Air Canada was still a Crown corporation, with highly advantageous access to capital. PWA and Wardair were able to raise new equity through the sale of shares.

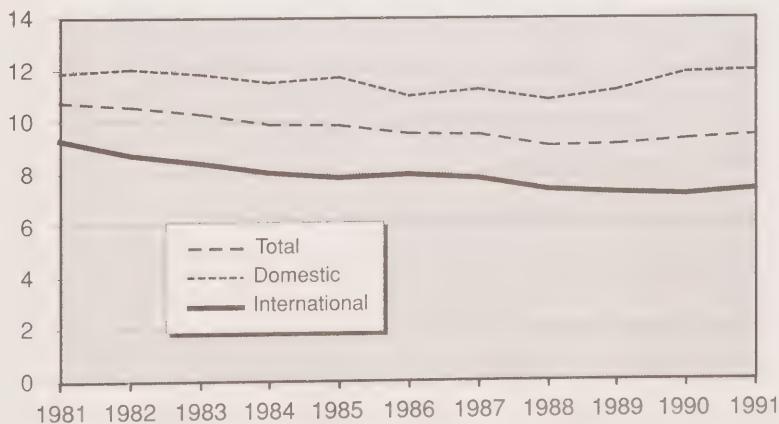
The year 1988 was an excellent one for air traffic, and a more modest expansion was also recorded in 1989. The carriers had achieved relative market parity and might have been expected to lessen their intense and expensive competition, especially since Air Canada was privatized over this period and now served profit-oriented shareholders.

By December 31, 1989, Air Canada's balance sheet was much healthier than two years before, whereas Canadian Airlines International's situation had deteriorated.<sup>12</sup> Nevertheless, a casual observer might have concluded that the market-place was normal. But detailed observation would have detected worrisome trends.

Domestic air traffic was essentially stagnant. The decade ended with traffic down 6% from 1981. In addition, airline yields, a critical measure of carriers' financial returns, were falling almost yearly in the international and transborder markets. By 1991, yields from international flights averaged only 61% of domestic yields. (See Figure 4.4.)

**Figure 4.4**  
**Yield on Scheduled Air Passenger Services**

Real Terms: Cents per Passenger-kilometre (1986 cents)



SOURCE: Statistics Canada

When the *NTA, 1987* was passed, operating ratios (a measure of operating expenses in relation to operating revenues) were 94%. Four years later, in 1991, operating expenses exceeded operating revenues. This was a sign that owners' equity was being bled off to keep the carriers operating.

### Mergers

Canadian Airlines International was formed by PWA through the integration of CP Air, Pacific Western Airlines, Nordair and Eastern Provincial Airlines. The challenge of integrating different companies had a significant impact on the operator's overall cost. By 1991, PWA had lost the substantial cost advantage over its rival that its predecessor carriers had enjoyed.

The 1989 purchase of Wardair was the most ambitious merger and came at enormous cost to PWA shareholders.<sup>13</sup> This was a fateful decision, because intense market-share competition continued even with the third carrier removed.

### Aircraft Purchases

The year 1990 has been accurately described as the beginning of the crisis for the Canadian airline industry. Airline passenger traffic in Canada fell 15% in 1991, due in large part to factors such as the Gulf War and the introduction of the GST. The recovery in the first three quarters of 1992 has been only of the order of 4%. Air Canada and Canadian Airlines International both incurred net losses in 1990; in 1991, the losses were much greater; and in January-September 1992, Air Canada lost \$307 million and Canadian Airlines International \$106 million.

But perhaps it was aircraft purchasing decisions in the late 1980s that proved most crucial. By the end of 1989, Air Canada was committed to a \$3.8 billion fleet renewal-expansion program, with 47 aircraft to be delivered in 1990-94. (Air Canada's total operating revenues were \$3.1 billion in 1989.) Canadian Airlines International's commitments in 1988 for aircraft deliveries in 1989-94 were \$1.6 billion, while lease and option contracts covered a further 52 aircraft. The effects of these purchasing decisions on long-term debt and capitalized leases are shown in Figure 4.5.

**Figure 4.5**  
**Long-Term Debt + Capitalized Leases**

Millions

	Air Canada	PWA	Total
As of:			
December 31, 1983	\$1093.00	\$ 983.00	\$2076.00
December 31, 1991	\$3017.00	\$1523.00	\$4540.00
Percent increase	176%	55%	119%

SOURCE: Sypher

Some newly delivered equipment was consigned to storage because it was not immediately required. In 1991, Air Canada still had \$1.4 billion in new aircraft commitments and Canadian Airlines International \$0.9 billion. Airlines in Canada were not alone in ordering a large number of new aircraft in the 1988-89 boom period. But major U.S. carriers and other foreign airlines have cancelled orders or deferred deliveries to survive the current crisis. Driven by aggressive competition, Canada's airlines have apparently been slow to reduce their commitments.

Air Canada and Canadian Airlines International's debt/equity ratio deteriorated to 77/23 by the end of 1991, worsening in 1992. The two major airlines have virtually no access to new equity capital because of their excessively leveraged balance sheets, low share prices and continuing operating losses.

It is easy but not completely fair to criticize various corporate strategies. Airline mergers were extremely common throughout the world during the 1980s, and most airlines assumed large commitments for aircraft during the same period. Certainly it was not only the airlines that were surprised at the severity of the recession which was to commence in mid-1990. Nonetheless, we do conclude that their difficulties were largely a product of the carriers' decisions, and not unique to a market which had recently been deregulated.

We also observed that government regulation is not necessarily protection from a recession. Severe labour reductions are occurring in airlines around the world, both in highly deregulated markets like the U.S. and in highly regulated markets such as France, and Germany. Lufthansa, which is still majority-owned by the German government, lost \$802 million in the first half of 1992, despite growth in traffic. Air France was recently refinanced with \$1 billion in state investment and more appears to be needed.

### Today's Market

Our research also suggests that a substantial shift in the economics of the airline industry has taken place. A major test of airline management skill, at any time, is the acquisition of aircraft assets. The dramatic decline in the market value of aircraft assets, combined with low inflation expectations for the near future, has deprived the airline industry of significant amounts of its underlying value, seriously complicating investment plans and financing. Some of the aircraft in Canada's airline fleet have lost more than a third of their value in less than three years.

In addition to this factor, the basic business of moving passengers is today a difficult one in which to realize large profits. Customer loyalty is low and demand appears to be very price-elastic.

Like other service industries, airlines have difficulty differentiating their product in a homogeneous market. Few innovations can be protected from imitation for long, while different levels of service are limited by the commonality of the aircraft, terminal facilities and workforces involved. In addition, there are unique technical challenges relating to capital investment in the sector.

In the 1980s, there was a lengthy "queue" for new aircraft orders. Airline executives found themselves placing huge orders years in advance, then happily riding the appreciating value of an asset in great demand or dolefully attempting to unload options or actual assets into a shrinking market. The two major carriers in Canada are now suffering seriously from the latter condition. There is a huge overcapacity in the Canadian industry, as is demonstrated by the example in Figure 4.6.

**Figure 4.6****Over Capacity – Toronto to Vancouver Daily Service, Summer 1992**

Company	Departure Time	Air Craft Type	Seats
AC	7:00	320	137
Canadian	8:45	767	222
AC	8:50	767	188
Canadian	10:00	DC10	255
Canadian	10:45	767	222
AC	11:00	767	188
Canadian	12:45	320	132
AC	13:15	767	188
Canadian	14:45	320	132
AC	15:20	767	188
Canadian	16:55	767	222
AC	17:00	767	188
Canadian	18:55	767	222
AC	18:59	767	188
AC	21:10	767	188
<b>TOTALS</b>			
Flights and Seats		15	2,860
Daily Traffic – Domestic & International Passengers (1990)			1,250

SOURCE: Sypher

The supply/demand balance is difficult for even one operator. Markets grow slowly, but to increase service to meet demand means the introduction of an additional aircraft, which tends to oversupply the market — however briefly — when it is deployed. One cannot introduce half an airplane into a market. Additional operators fighting to meet the same growth projections will exacerbate the situation. Since airlines services are a very perishable product, the impact of excess capacity is very serious. The moment the aircraft leaves the ground, the value of an empty seat becomes zero. Almost any return is better than nothing. Consequently, there is a natural tendency to price with increased competitiveness to ensure a full aircraft, but it is not easy to isolate the impact of such pricing to the empty seats. Instead, the price cutting affects the overall market.

### Market Size

During our consultations we encountered the allegation that "Canada's market is too small to support two major carriers and therefore a monopoly is necessary." We do not endorse this suggestion that the market is somehow dysfunctional. Many Canadian industries are dependent on international success to sustain themselves because they are larger than Canada's market will support. Canada's two largest air carriers have occasionally been highly profitable in some international routes and enjoyed a relatively large domestic market. For example, their combined revenues in 1990 exceeded \$6 billion.

We recognize that a monopoly might be the most advantageous model for the operator, but we cannot see why consumers should be placed in this situation. The argument seems to imply that a "major" air carrier must be of a certain character and size and that it is the market which must adjust to support it. In fact, Canada is served by numerous air carriers and many mix domestic and international operations.

Distinctions between "charters," "regionals" and "national" scheduled carriers imply that different economic forces are working in each category, but in fact airline management in each category is working with the same essential business equations of price, demand, capacity and cost. None carries special public duties, and each structures its operations in the manner most likely to profit.

### Future Prospects

In Annex A of this report, we examine a number of methods by which government could encourage competition in the marketplace, even in the event of the failure of one or the merger of both major carriers. Our conclusion is that partial, "imported" competition will not satisfy consumer demand and that protectionism will encourage further "leakage" to the United States. We also conclude that any significant domestic competition from any source would, in all likelihood, place insupportable pressure on the existing scheduled operators.

In the fall of 1992, a choice seemed to be developing between a highly protectionist strategy, which might preserve one or both carriers with much of their employment, and a competition oriented strategy, which would benefit consumers but likely damage the vulnerable Canadian operators. This bleak choice may have been deferred through a series of actions: Air Canada's announced investment in Continental Airlines and its alliance with United Airlines (UAL); PWA's employee participation, further negotiations with American Airlines (AMR) and financial support of \$50 million from the federal government; and the Government of Canada's continued negotiation of a bilateral agreement with the United States ("Open Skies").

This situation was not resolved as our report was finalized, and neither carrier could be considered financially secure. Both are still high-cost operators, and both have excesses in aircraft capacity and labour. But we feel that it was generally understood that Canada's airline sector is not purely a domestic industry and its future can only be planned within an international context.

At the time of writing, it is difficult to see how the existing operators can survive without serious rationalization, new sources of capital and perhaps some form of protection from competition. However, the essence of a competitive market-place is the freedom to fail, and there is no reason to believe, even in a worst-case scenario, that Canadian consumers must be deprived of essential air services or that Canada's large domestic airline market would not employ tens of thousands of workers — regardless of the fate of these specific incumbent companies and their creditors.

We therefore have attempted to examine two aspects of the industry which are not directly connected to the fate of the two largest existing operators. First, we consider the factors which will be necessary for success by Canadian air carriers, including improved operating costs and infrastructure.

Air Transport Association of  
Canada

*"In the 1990s viability  
means profitability for  
Canadian air carriers and  
profitability means reducing  
costs."*

Second, we examine the coming evolution of international airline regulatory structures, which may offer both challenges and opportunities to Canada.

### **Industry Strategies**

Successful Canadian carriers will have to be lower cost operators with a secure position in an airport hub. They must also be involved in a number of alliances with other carriers. Longer-term government policy must support such a situation while playing a strong role in the enforcement of competition laws to deter market abuses.

### **Costs**

The airline industry in Canada can ensure its survival only if it moves rapidly to drive its unit costs down toward U.S. levels. In 1991, the average unit cost for the largest seven U.S. carriers combined was \$.106 per revenue passenger kilometre (RPK)<sup>14</sup>; Air Canada's and Canadian Airlines International's combined average unit costs were 50% higher. Table 4.1 summarizes this comparison.

Clearly, significant additional productivity gains will be a key part of any effort to bring costs in line with the U.S. marketplace. As Table 4.2 indicates, U.S. revenue passenger kilometres (RPKs) per employee are 35% higher than Canadian RPKs per employee for the major jet carriers.

Until the unit costs of jet carriers in Canada are closer to U.S. jet carrier costs, it is likely that the major Canadian carriers will not be competitive on transborder routes and many international routes and will be forced to cross-subsidize these routes from high domestic fares.

**Table 4.1 Comparison of Top Seven U.S. Carriers<sup>1</sup> with the Canadian Level I Carriers**

	1991 (millions)	
	U.S.	Cdn
Revenue	\$57,083	\$6,441
Operating Expense	\$58,254	\$6,695
Operating Profit	(\$1,171)	(\$254)
Profit Margin	-2.05%	-3.94%
Interest Expense	\$1,349	\$254
Wage Expense	\$20,043	\$2,059
Fuel	\$8,387	\$937
ASK <sup>2</sup>	875,522	63,576
RPK <sup>3</sup>	549,664	42,130
Cost/RPK	\$0.1060	\$0.1589
Cost/ASK	\$0.0665	\$0.1053
Revenue/RPK	\$0.1039	\$0.1529
Revenue/ASK	\$0.0652	\$0.1013

1. U.S. carriers include AA, DL, NW, WN, UA, US, HP. Canadian carriers include Air Canada,

Canadian Airlines International

2. available seat kilometres

3. revenue passenger kilometres

**Table 4.2 Comparison of Three U.S. Carriers<sup>1</sup> with the Canadian Level I Carriers**

	1990 U.S.	1990 Cdn	1991 Cdn
Employees	219,000	40,000	36,600
RPK (millions)	339,534	48,685	42,130
	1,550,385	1,217,120	1,151,082

1. U.S. carriers include AA, UA, DL. Canadian carriers include Air Canada, Canadian Airlines International

## Airport Hubs

Successful carriers of the future will dominate a large "hub" airport. The "hub and spoke" system is one of the most common forms of airline networks and offers airlines many ways to maximize revenues and control costs. There are several variations to hub and spoke. The simplest hub is one central point connected to cities on the periphery. In Canada, the airlines operate an essentially linear network, with regional gateways in Halifax, Montreal, Toronto and Vancouver. In the United States, most carriers operate several hubs, each strategically situated to serve traffic between specific quadrants.<sup>15</sup>

Several elements account for the popularity of hub and spoke systems. The most important is economies of scope. This concept applies when a firm already offering certain services enjoys a competitive advantage in broadening its product line still further. A hub network offers economies of scope because each spoke supports every other. If an airline operates a hub with flights to 20 cities, it can serve 210 city-pairs. If the airline adds 20 more spokes to the hub, it can serve 820 city-pairs. While doubling its costs, it has almost quadrupled its revenue potential. The process continues until the airline either exhausts the selection of possible points, experiences hub congestion or experiences a loss of traffic from other companies following similar strategies.

It allows carriers to serve a passenger for the entire journey rather than rely on other airlines for traffic feed and be forced to share through ticket revenues with competitors. It also makes possible service to smaller centres that have too little traffic for even a modest nonstop service. It allows carriers greater control over product quality. A large portion of the company's activity occurs at a few strategic points, where it can be monitored closely.

However, many U.S. hubs are saturated. Expansion of services becomes difficult because of runway constraints and very high investment costs.

In a more liberalized environment, congestion in the U.S. may offer an opportunity for Canada. Two airports in Canada, Toronto's Lester B. Pearson International Airport and Vancouver International Airport, have the potential to be significant, if not dominant, hubs both domestically and continentally. Other airports, especially Montreal, may benefit from their geographic location and uncongested infrastructure. Although the linear nature of the Canadian market prevents Pearson and Vancouver from achieving the same strength as some major U.S. hubs, they can still serve a larger and growing market if provided with the necessary infrastructure and services. The potential for growth, with its associated employment and economic impacts, is high.

Toronto owes its current aviation dominance in Canada to the large size of the local market. This alone is sufficient to assure Toronto's hegemony. Toronto dominates Canadian traffic flows to a far larger extent than New York prevails over the rest of the United States. In 1991, over 21% of Canada's domestic passengers were either enroute to or travelling from Toronto.<sup>16</sup>

Despite Toronto's importance as a gateway to Canada, Pearson is, at present, less oriented to connecting passengers than many other airports. Less than 25% of Pearson's traffic is connecting, while at some U.S. airports this proportion exceeds 50%.

On August 19, 1989 the government announced that it would construct three new runways at Pearson, raising capacity an estimated 25%. However, three years later, the environmental assessment review had not yet been completed. A program to refurbish the terminals at the airport was announced on October 17, 1991, but a contract was not awarded until December of 1992.

In Vancouver, an additional runway was announced in 1990 and an environmental assessment review completed. However, as noted in Chapter 6, while the project has full approval, it has been delayed by financing complications.

Both Pearson and Vancouver have experienced difficulties with air traffic control shortages, a situation that became so serious in Toronto that the airport's capacity was capped at 72 flights per hour in 1989 and has only recently returned to its engineered performance standard of 82.

Pearson's potential is also affected by limits on air carriers' access under Canada-U.S. air transport agreements and by customs limitation.

The development of these facilities at a faster rate is a critical priority since it could position those cities and Canadian carriers to seize important growth opportunities.

### Alliances

Because airline alliances across national boundaries seek to mimic the benefits of a single multinational carrier, they frequently challenge existing regulatory barriers. Lengthy delays can be incurred by the operators as each new precedent is considered.

Alliances are designed to achieve two key benefits, including "capturing" the passenger through code sharing, schedule integration, prorating and frequent flyer programs so that the passenger will use the alliance for travel anywhere in the world, and cost reduction through better use of existing resources and through use of low cost facilities.<sup>17</sup>

Alliances are not uniform. They range from outright majority control to very loose code-sharing or marketing agreements.

British Airways is a prime example. This carrier:

- owns 49% of Deutsche BA, a German domestic carrier,
- owns 49.9% of TAT, a French Domestic carrier,
- had made an offer for 44% of the total equity of US Air (and 21% of the voting interest),
- has been negotiating with KLM and is currently bidding on a 35% stake in Qantas, and
- has a stated intent of creating a Global Master Brand — a single name, and network and so on — within the next three years.<sup>18</sup>

## Multinational Groups

Many industry analysts believe the world airline industry will be reduced to six to eight carrier "families" or alliances within the immediate future and that these alliances could carry 90% of the world's revenue passenger kilometres.

One analyst<sup>19</sup> recently predicted the key carriers would be American, Delta, United, Northwest/KLM, British/US Air, Air France, Lufthansa and JAL/ANA.

Some of these operators are interested in alliances with Canadian carriers. Canada has a large domestic market, and the two major Canadian carriers are not insignificant.

Observers have predicted the emergence of multinational carriers for years, and we do not expect national boundaries to disappear overnight. But it would be shortsighted not to prepare Canada for this eventuality.

## International Considerations

We believe the 1944 Chicago Convention, which served Canada well for decades after World War II, is now becoming a disadvantage, limiting the marketplace for Canadian carriers and encouraging protectionism. The regime established by the Chicago Convention divides the world aviation market into a huge patchwork of "bilateral" exchanges, offering no prospects for growth beyond the scope of the home country's population.

No matter how effective a Canadian carrier might be, its service to large markets like Germany, the United States or Japan will be limited by the Canadian demand for that market. If these rules had applied to other Canadian service industries, successful international performers such as engineering, entertainment and telecommunications companies would have been seriously restricted.

We believe that the airline sector is on the brink of major change. Large transnational investments — KLM in Northwest Airlines, British Airways in Qantas, Air Canada in Continental — are indications of the future. It is the movement of needed capital which is breaking down protectionist barriers.

In their place may be domestic and international alliances, an approach which is already underway faster than governments worldwide are prepared to deal with it. Protectionism may give way to an era in which states compete to host all or part of concentrated airline groups.

Canada must be ready if and when the old order passes. A new standard for evaluating foreign investment in Canadian aviation should be designed, modelled after Canada's approach to other sectors involving multinational entities and stressing guarantees of employment or investment rather than national ownership and control. Though this approach, which might be termed the "Investment Canada"<sup>20</sup> model, may be difficult to introduce, it has obvious strengths. It is based on the assumption that production of services is mobile, and as we commented earlier in this report, the government's chief concern lies with the overall strength of the economy rather than protection of individual enterprises. It may be that in the airline industry, as in others, governments will soon both facilitate foreign investment in their carriers and encourage the establishment of foreign-owned carriers.

## RAILWAY CARRIERS

### Background

Although the Canadian railway network comprises 25 railway companies, the dominance of a duopoly of Class I railways remains the most prominent feature of the industry.

Canadian National and Canadian Pacific dominate the Canadian rail industry. Their networks include 89% of main and secondary lines in Canada and they handle a similar proportion of the country's rail freight traffic. Clearly this poses a challenge for a transportation policy dedicated to competition.

The main thrust of rail provisions of the *NTA, 1987* was directed toward this challenge, and a number of measures were created to assure a competitive advantage for shippers. Devices such as confidential contracts,

expanded interswitching limits, competitive line rates and final offer arbitration were all products of the Act designed to encourage greater competition.

Five years after their creation, we have concluded that these provisions have indeed benefitted the shippers they were intended to serve. However, the situation faced by the railways has deteriorated and may become very serious in this decade.

Competitive pressures have forced down the rates which the railways have been able to charge shippers. The most profitable traffic has often been lost to the trucking industry. The railways are largely left with the transport of bulk products, where rate increases are constrained because these products are required to compete in highly price-competitive world markets.

Attempting to reverse the clock and tag the shipping community with higher costs would be both ill-conceived and unsuccessful. The challenge, then, lies in an agenda for the rail sector which allows its transition to a competitive, healthy industry serving Canada's commodities and manufacturing industries.

## History

Arguably, Canada has never had a stable, market-driven railway sector. The Canadian Pacific Railway (CP Rail) was granted a monopoly as compensation for the huge costs of the original transcontinental line. When the monopoly expired, Canada was embroiled in a frantic era of railway speculation. This era collapsed in spectacular fashion and led to the creation of the Canadian National Railways (CN) in 1919.

Council of Forest Industries of  
British Columbia

*"We firmly believe that the viability of the Canadian railways depends primarily on them competing, focusing on their strengths and continuing to be more innovative, productive and market oriented."*

Hardly a commercial venture, CN was born of four bankrupt railways, themselves parents of dozens of smaller, defunct lines. Far from building on a growing market, Canada's rail sector has had excessive capacity for all of this century and has carried huge debts — \$1.3 billion in 1924.

Not surprisingly, much of the history of Canadian railways since that time has been a curious battle to simultaneously invest in competitive infrastructure, while escaping the excess. Meanwhile, the trucking industry has steadily eroded the railways' traditional markets and has surpassed the railway as the preferred means of transport for many markets, including short haul, or light manufactured products.

### **The 1980s**

From 1980 to 1991, railway freight traffic increased by roughly 1% per annum. This was a slower rate of increase than in previous decades. At the same time, traffic in manufactured goods continued to shift away from rail to trucking.

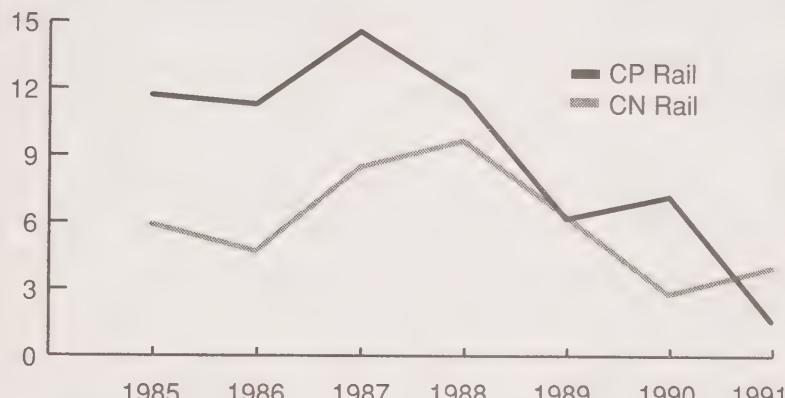
This fairly stagnant market forced continued rationalizations within both Class I companies. Railway employment in Canada fell dramatically through the 1980s. CN currently employs 31,900 people (1991), down 44% from 1981. CP Rail employs about 22,000 people (1991), a fall of 35% from 1981. Track has been abandoned and the use of rail cars and other resources has also been reduced.

We are concerned with the rigidities of railway cost structures, which have been unresponsive to revenue declines. Since revenue projections for the future are flat or downward, we believe that Canada's rail sector has become quite vulnerable and will require rapid adjustments in both internally and externally generated costs.

### **Financial Outlook**

The pre-tax rates of return on capital earned by CP Rail and CN are depicted in Figure 4.7.

**Figure 4.7**  
**Rates of Return (%) CP Rail and CN Rail**



SOURCE: IBI

In 1988, the operating ratios of both companies averaged 85%. By 1989-90 CN's operating ratio had increased to 94.4% and CP Rail's stood at 90.8%.

If the end of the recent recession permitted a return to 1988 levels, which is far from assured, carrier finances still would not be healthy. A ratio of 80%, for example, would represent a reasonable but not spectacular return on investment of 10.5%. But to achieve this level, the railways would need to find \$470 million in annual savings or revenues.<sup>21</sup>

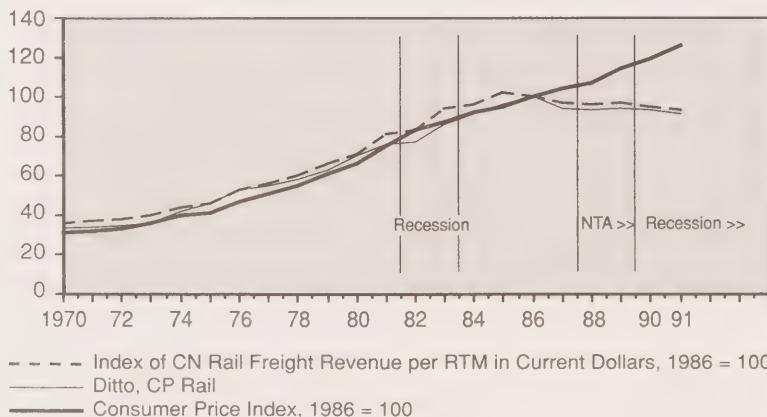
New capital investment by the railways declined throughout the 1980s, with the only major exception being the heavy investment by CP Rail in the new Rogers Pass tunnel. In real terms, the combined average annual capital investment by CN and CP Rail from 1989 to 1991 was only 40% of the figure recorded for the 1982 to 1984 period. Railway equipment does not

have an indefinite lifespan and replacement cannot be postponed forever. Eventually reductions in capital spending will affect those investments essential to ensure the safe and efficient movement of trains.

The average revenue per ton-mile for the two railways has also declined. After following the consumer price index very closely for years, railway revenue per ton-mile fell abruptly in 1985, and continued to fall in current dollars for the rest of the decade (see Figure 4.8).

**Figure 4.8**  
**Freight Revenue and Price Index, 1970-91**

Index 1986 = 100



### Comparison with U.S. Railroads

The performance of the Canadian rail carriers might be of importance only to their shareholders if it were not for the presence of Class I railroads in the

United States, some of which are in a position to offer competition for Canadian shipments.

Prior to the *Staggers Act* of 1980, U.S. railroads were subject to very detailed economic regulation. In the decade preceding the *Staggers Act*, the financial situation of major U.S. Class I railroads deteriorated. Some lines experienced increases in rail accidents due to deteriorating infrastructure, while other major railroads in the northeast went bankrupt. In response, the U.S. government created a state-owned company, Conrail, to take over the bankrupt railroads. The federal government also adopted measures which favoured the rationalization of the rail network and it provided financial assistance to other ailing carriers.

The passage of the *Staggers Act*, coupled with fiscal encouragement to railroad investment and financial assistance to maintain services required in the public interest, helped reverse the situation. The U.S. railroads emerged from this period with a competitive advantage over their Canadian counterparts. In the decade that followed the *Staggers Act*, U.S. railroads became more market-responsive, undertook sweeping rationalization programs and restored their financial viability. Conrail was subsequently privatized, and is now a profitable operation.

From 1981 to 1991, the number of employees of U.S. Class I railroads fell by over 50%. Today, employment compensation represents only 28% of the operating expenses of U.S. railroads. In Canada that figure is closer to 40%.

During 1989-90, the average operating ratio for U.S. Class I railroads was 88.2%. Of all U.S. railroads, only Norfolk Southern managed to achieve an operating ratio below 80%.

Clearly, Canada's railways must confront a real and growing competitive challenge from south of the border as they plan a future within a continental market.

## Planning for the Future

We believe that the evidence demonstrates that Canadian railways face serious challenges in the 1990s. The current situation is not sustainable. The eventual cost to the national economy, and perhaps to the government as the shareholder of CN, could be very great.

Even an optimistic observer would acknowledge that Canada's railways cannot make a contribution to increasing national economic competitiveness unless major changes are made to their structures and costs.

We believe that a national strategy is necessary to return the rail sector to health. We believe that strategy will require the active participation of railway management and labour, as well as that of the federal and provincial governments.

We also believe that there is some evidence that shippers are increasingly prepared to support changes which could make the railways more competitive. But the task is daunting nonetheless.

On the next few pages we offer the elements of a strategy to reduce the costs which plague our rail carriers.

Railways must be allowed to lower their infrastructure costs through plant rationalization — by way of abandonment or conveyance of lines to short line operators, by way of track sharing, and possibly by separating railway infrastructure from the operation of trains.

Efforts are required to bring labour costs and productivity levels in line with those attained by the U.S. railroads and evident in our trucking industry. Finally, some way must be found to alleviate the tax burden on the Canadian railways.

### *Plant Rationalization*

The first and most significant cost item which lies within the control of the government is the easing of restrictions on track rationalization. These restrictions have forced the maintenance of oversized rail networks for both of Canada's Class I railways.

The issue of rail abandonment has been debated for years. It continues to evoke strong feelings today. Attitudes formed when the railways were unchallenged monopolies have lingered, even though the competitive situation of the railways has dramatically changed. We believe that it is now appropriate, and indeed essential, to liberalize the rationalization process. It is time to allow railways to respond to their declining revenues with appropriate cost reducing adjustments.

However, we recognize that the loss of a rail line can be traumatic for shippers and for municipalities. As a result, we have attempted to consider mechanisms by which public authorities could continue service for public policy reasons after the original operator had announced its intention to exit the market.

As noted earlier, Canada has had excessive rail capacity since the 1920s. We have also allowed economic considerations to play a steadily increasing role in the rationalization debate through the last three decades. The *NTA, 1987* took a substantial step by declaring that economic considerations would be paramount in the decision-making process. If a line is losing money, the carrier will generally be allowed to exit. The public interest override of that decision is only valid if the National Transportation Agency determines that profits are a probability in the future.

This removed the social and regional considerations which had been a part of the 1967 legislation.

The new Act imposed a statutory limit on abandonment applications. During the first five years after passage of the Act, a railway could not abandon more than 4% of total trackage in any one year. We note that neither CN nor CP Rail utilized its entire 4% limit in any year. In fact, from 1988 to 1992 CN applied for only 7% of its total trackage and CP Rail for 9%.

It is not entirely clear to us why the railways have not used their full allocations. But we suspect that the restrictiveness of the process, its cost and its complexity serve as an impediment. A degree of internal resistance may also have been a factor.

Plant rationalization could considerably reduce the operating expenses of Canadian railways. According to CN, for example, just one-third of the company's track handles 90% of its tonnage.

In 1990, the average density of traffic on CN and CP Rail together was 9.8 million gross ton-miles per mile of track. This represented only 60% of the traffic density achieved by the seven largest U.S. railroads.

Within the Canadian rail system, 3,200 miles of track is very low density line, carrying less than 0.2 million gross ton-miles per mile. This very low density track accounts for about 10% of the total track. If this trackage were abandoned, there would be a saving of almost \$50 million per annum to the Class I railways.

A further 10,800 miles of track, constituting 34% of the total railway mileage, is low density. If this trackage was abandoned or sold as short lines, there would be a further annual savings of \$210 million. Overall, some \$260 million per annum could be saved if both very low and low density track were removed from the mainline networks.

We believe that the freedom to enter and exit a market is an essential feature of the competitive marketplace. We also believe that the size of the physical plant has a strong connection to levels of employment and corporate structures. The size of that physical plant must be changed if Canadian rail carriers are to effectively compete with our continental neighbours. This process of plant rationalization must meet three goals. First, it should allow commercial freedom for railway operators to exit a market without having to demonstrate financial loss or the absence of public need. Second, the process should permit a reasonable opportunity for commercial, provincial or local community interests to acquire railway lines in which national operators are no longer interested. Third, since the interest of the railway may differ from the interest of the nation, the process should allow governments to assume responsibility for railway lines found to serve the public interest.

The *public interest* is a concept which could be subject to abuse if it is not carefully defined. We believe, however, that if the public interest were properly defined and the process we propose prudently administered, the

Canadian taxpayer would not become responsible for uneconomic railway lines, except in the most compelling circumstances. Those compelling circumstances might include interswitching access and a rail line that provides the only land transport access to an isolated communities. It will be important to establish clear public interest criteria before any revised regime is enacted.

We have attempted to design a regime which, while recognizing that business decisions should not be hindered, also permits flexibility in arranging the disposition of railway lines. For example, part of a line could be sold privately by a national carrier; part might be sold through the regulatory process to a short line operator or provincial government; part might be operated by a contractor in the public interest; or part might be maintained but not operated, for an identified future public use. In any case, recognition of the public interest should not entail inappropriate public expense.



#### RECOMMENDATION NO. 8

We recommend with respect to abandonment of  
railway lines:

*Freedom to Exit and Public Interest Duty*

- (a) The *NTA, 1987* be amended to permit federally regulated railways to discontinue railway line operations, whether through conveyance or abandonment, without being required to demonstrate financial loss or absence of public need; and
- (b) As a condition of the preceding recommendation, the *NTA, 1987* be amended to confer on the Agency a general jurisdiction to determine

whether abandoned railway line should be conveyed, retained or operated in the public interest.

### *Flexibility of Outcomes*

- (c) The abandonment and line conveyance provisions of the *NTA, 1987* be amended to allow for the combination of several possible usage outcomes for the particular railway line sought to be conveyed or abandoned.

### *Abandonment Procedures*

- (d) As a condition of its abandonment notice, a railway company be required to submit to the Agency:
  - i) a reserve proposal to provide annual operating and capital renewal services for the railway line; and
  - ii) information on traffic and infrastructure condition to be provided to outside parties for the purpose of tendering offers for the purchase and/or operation of all or part of the railway line.
- (e) During the six-month abandonment notice period, the Agency shall determine whether some or all of the railway line should be sold, maintained, or operated in the public interest. The Agency may hold public hearings for this purpose.
- (f) If the Agency determines that no public interest exists in any or part of the railway line:

- i) any parties shall have the right to submit offers for the purchase of such railway line within 15 days of the Agency's decision;
- ii) the Agency may extend the effective date of abandonment pending negotiations between the railway company and offerors;
- iii) if no offer is received, the Agency shall advise the railway company, which would then be free to dispose of its property at the end of the six-month abandonment notice period.

(g) If the Agency determines that any part of the railway line is in the public interest, the Agency shall publish invitations to tender bids for the purchase of the railway line or to provide services for its annual capital renewal or operation.

(h) Where tenders are made for purchase of public interest railway line, but none is accepted by the railway company, the Agency may extend the effective date of abandonment pending negotiations, or, at the parties' option, provide for arbitration of the purchase terms.

(i) Where no purchase offer is received for public interest railway line, the Agency shall pay net salvage value of the railway line to the railway company, and assume ownership of that railway line as agent for the Crown. After evaluating the reserve proposal and any tenders received, the Agency shall accept the most suitable offer and grant maintenance or operating authority within the six-month abandonment notice period.

(j) The railway company's common carrier obligations would cease at the completion of any sale, at the end of the time period of its accepted proposal or at the expiry of a prescribed period, after which the successful bidder would assume maintenance or operation of the railway line.

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Other appropriate procedures relating to this process could include requiring evidence of financial responsibility from bidders seeking to operate a public interest railway line. The Agency could be required to review, at reasonable intervals, whether all or part of a railway line acquired by the Crown in fact needs to continue to be owned, maintained or operated in the public interest.

### *Section 175*

One section of the *NTA, 1987* which various groups identified as a disappointment is section 175. We believe that this section could play an important role in the evolution of the rail sector.

In the case of a branchline under subsidy, section 175 (1) of the *NTA, 1987* allows the Minister of Transport to enter into an agreement with a province, municipality or shipper to provide funds to improve alternative transport facilities, if this would be more cost-effective than the subsidy payments. The payments under section 175 (1) cannot be more than the net loss registered for the rail line for five years. The funds can be used only for capital projects.

This section has been used only once since 1987, and that was in the case of Borden Mercantile Company of Victoria, B.C., in early 1991. We are aware, however, of programs in the grain industry which have been used in the past to replace rail operations by truck transport with the agreement of all parties concerned.

In the case of a grain dependent branchline ordered to be abandoned, section 175(6) of the *NTA, 1987* allows the Minister of Transport to enter an agreement similar to that permitted by section 175(1), if it is demonstrated that one or more shippers would suffer significant economic harm as a result of the abandonment. No assistance has been provided under this section, although requests have been made.

There is an inconsistency in the operation of this section. To qualify for the section 175 subsidy, the line must have successfully been petitioned for abandonment and its continued operation must also have been deemed to be in the public interest.<sup>22</sup> Since continued operation of a rail line means that no alternative method of transportation is required, this section has been essentially dormant. We recognize that there has been a reluctance on the part of the government to use alternative funding more extensively, because it makes the government a direct participant in the abandonment process.

Nevertheless, the basic concept of section 175(1) is one that we generally endorse. We have already recommended that the government become a more active participant in the rail rationalization process, and section 175 represents an important device in such a process. Subject to the adoption of an accelerated abandonment regime, section 175 should be carefully considered by the government as a means of helping shippers and municipalities out of their dependence on inefficient rail operations and into more effective alternative forms of transportation.

### *Prairie Branchlines*

The slow pace of abandonment over the last four years is also the result of cabinet decisions. More than 6,000 miles of prairie branchline track is protected by orders-in-council until the year 2000. This trackage is not subject to abandonment applications. This has resulted in the continued operation of many branchlines which carry minimal amounts of traffic. Uncertainty surrounding the future pattern of grain branchlines in western Canada is impeding the efficient planning of the entire grain handling system, from the farm to the country elevator to the port.



### RECOMMENDATION NO. 9

We recommend that rationalization of the prairie branchline structure not be delayed.

#### *Short Lines*

One of the most interesting innovations to have emerged in the railway industry in the last decade has been the short line railway. Common in the United States, they have begun to emerge in Canada as well. They represent a promising alternative to our current rigid structure. They are usually established through the abandonment or conveyance of a low density line which a Class I railway can no longer profitably run. Short lines are generally characterized by their lower operating costs, their close attention to customer needs and the opportunity they represent to maintain service on a line which would otherwise be abandoned.

Short lines were not a unique development of U.S. regulatory reform, having always been present to some extent. Most of the rail rationalization in the early post-Stagger Act years was abandonment. By the mid-1980s however, it became more common to convey a line to a local operator than to aban-

Southern Rails Cooperative Limited

*“Short lines must not be allowed any longer to fall between the cracks of legislation.”*

Shipping Federation of Canada

*“Because of the restrictions in the NTA and in the Canadian regulatory process, neither Canadian shippers nor Canadian railways can benefit from the so-called “short line phenomenon” which has revitalized many local and regional rail lines in the United States and been a boon to the commercial health of the major rail carriers.”*

don it outright. In the huge rationalization of U.S. rails, 34% of the route mileage in 1977 was trimmed from the Class I railroads' networks, but only 18% was actually abandoned. All the rest has been served, for at least some length of time, by short line operators.

The Central Western Railway was the first short line of the modern generation in Canada. Located in Alberta, the Central Western Railway serves grain traffic. It employs 28 people and moves approximately 400,000 tonnes of grain a year, although this figure fluctuates in response to grain production.

Central Western's rise was a tortuous process involving legal challenges that were ultimately resolved by the Supreme Court of Canada in December 1990. The crucial effect of the case was to put under provincial jurisdiction short lines located entirely within a province whose operation is not "integral to the operation of a federal work or undertaking." As a consequence, these types of short lines are not obligated to continue labour contracts negotiated by the Class I railways under federal jurisdiction. This has allowed these small lines to lower operating costs and provided them with greater flexibility. This workforce flexibility is a crucial advantage which makes such operations potentially viable in many locations where Class I carriers have been unsuccessful.

A second short line rail was created by Southern Rails Cooperative in Saskatchewan and a third by the conveyance of CN track to the Goderich & Exeter Railway of Ontario in 1991. A fourth transaction is currently being processed in a hotly debated conveyance of the Sydney-Truro line in Nova Scotia. CN and CP Rail recently announced additional lines in Quebec, Nova Scotia and Ontario will be available for similar conveyance in the near future.

We believe that the short line phenomenon has great importance to the railway sector. It is not a magic solution to railway ills, but it does offer an attractive alternative to abandonment. Short lines can provide an option for shippers and municipalities facing outright loss of rail service. The emergence of new railway operators, however small, may lead to innovations in both the operation and marketing of rail services. At best, a successful short

line can restore competitiveness in markets where high cost operators have been unsuccessful.

Since short lines can currently flourish only under provincial jurisdiction, their growth may stimulate a much needed overhaul of provincial rail regulation.

Despite the success of short lines in the U.S. and the establishment of the first few lines here in Canada, there are a number of important obstacles which retard the growth of the short line industry in this country.

First, there appears to be a lack of Canadian entrepreneurs ready to bid for available lines and a lack of venture capital to support those who are interested. The extremely long period of time between the initiation of an acquisition and that point at which an operator begins to generate revenue is another factor that discourages interest.

Short line operators may also be purchasing property that requires substantial investment to bring the infrastructure up to an acceptable standard. The business relationships with shippers may have deteriorated from lack of attention by the former carrier servicing the line. Regaining former rail customers may offer a challenge that takes a number of years to overcome before a satisfactory revenue base reappears.

Though governments cannot solve these business problems, they can deal with the complexity of the conveyance processes, which involves both federal and provincial regulatory bodies. Provincial governments can respond to the lack of provincial legislation to address the start-up and ongoing regulation of short line railways.

Existing provincial legislation provides little comfort to local interests who are concerned that the failure of a short line would leave them with no rail service and no linkage to the national rail system.

Our research identified a number of other impediments to short line operations. Many of these problems stem from lack of clarity and certainty in government dealings with a new operator.



**RECOMMENDATION NO. 10:**

We recommend with respect to facilitation of conveyance of railway lines that:

*General Recommendations Respecting All  
Railway Line Conveyances*

**Procedure**

- (a) The current six-month period of notice to the Agency of a proposed railway line conveyance be reduced to 30 days and the Agency be required to approve the conveyance once satisfied that the proposed buyer of the interprovincial railway line can meet operational and safety standards or that the proposed buyer of intraprovincial railway line has operating authority under provincial law.

**Running Rights**

- (b) If the present *NTA, 1987* abandonment procedure is maintained, sections 158 and 174 of the *NTA, 1987* be amended to repeal automatic vesting of Via Rail Canada Inc. running rights and the declaration of the railway line as a work for the general advantage of Canada.<sup>23</sup>

*Particular Recommendations Respecting  
Short Line Conveyances*

**Subsidies**

- (c) To the extent that the present western grain transportation subsidy scheme is maintained, section 56 of the *Western Grain Transportation Act* be amended to clarify that intraprovincial short line railways are eligible for such subsidies on similar bases as the national railways.
- (d) To the extent that the *Maritime Freight Rates Act* and the *Atlantic Region Freight Assistance Act* schemes are maintained, these statutes be amended to clarify that the availability of such subsidies extends to carriage on intraprovincial short line railways.

**Labour**

- (e) The *Canada Labour Code* be amended to clarify that intraprovincial short line railways acquired by transfer from interprovincial railway companies are subject to provincial labour legislation.

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*Track Sharing*

In addition to the abandonment of low density lines, we believe that there could be substantial economies in rail operations through sharing track, where capacity is considerably underused.

To pursue this idea further, we have developed a prototype and prepared as a case study the economics of consolidating CN and CP Rail operations from Sudbury/Capreol through Northern Ontario to Winnipeg. The vast

majority of traffic in this area is bridge traffic, transiting through the region to distant points both east and west. Very little local traffic originates between Sudbury/Capreol and Winnipeg.

All traffic currently moving through this area and expected in the foreseeable future could be accommodated on one main line. If, for example, CN were to abandon its line through northern Ontario and route its traffic along the CP Rail line, there could be substantial operational savings.

However, our evaluation of joint track usage based on this case study raises several issues which must be addressed before the concept could be applied more generally in Canada.

For instance, the interests of two competing firms with a long tradition of non-co-operation in infrastructure sharing must be reconciled, and this must be done while maintaining a competitive environment for the benefit of the shipping community.

Isolated communities could be affected by the loss of local passenger and freight services. They could be left with no satisfactory transportation alternative. The differing operating practices employed by the carriers must also be accommodated, which may reduce some of the expected economies of scale.

CN and CP Rail have negotiated on the joint operation of main lines for almost a decade before reaching the first agreements. Although legislative impediments may have hindered co-operative rail sharing in the past, we have not been impressed with the extent of progress CN and CP Rail have achieved in the co-operative rationalization of their plant and operations.

CN and CP Rail have announced an agreement by the two railways for the joint operation of track in the Ottawa Valley. We welcome this development.

Nevertheless, we would still urge these two carriers to take speedy action on the potential for further joint rail sharing across all suitable areas of their systems. We encourage the federal government to act as a facilitator in this regard.



### RECOMMENDATION NO. 11

We recommend that the government encourage CN and CP Rail in their joint rail plant usage initiatives by developing policies and practices which are supportive of such initiatives.

#### *Common User Rail Plant*

A more all-embracing solution to plant rationalization is the possibility of separating the operation of railway infrastructure from the operation of trains and the carriage of goods.

Railway track and its associated infrastructure represent substantial fixed costs. These heavy initial costs inhibit the entry of new entrants into the industry. If the rail plant were separated from railway operations and administered as a separate entity, operating companies could compete on the publicly owned rail plant. This would be comparable to the position of motor carriers, who compete on publicly owned highways.

It should be noted that this approach encompasses more than the mere common usage of the track. It also includes issues such as track maintenance, control of train movements, the certification of personnel of carriers using the track, the establishment of priorities in track usage, the status of common carrier obligations, and determining user fees reflecting these various factors.

While this concept is not new, there has never been any comprehensive study of the benefits and costs, the likely emergence of new carriers, the logistics of administration and the extent and sources of capital for fixed plant investment.

We do not wish to make definitive recommendations in an uncharted area. Nevertheless, we are impressed with the prospect of competition on a

single rail track, which this type of arrangement could bring to pass, and the resolution of the problem of securing effective intramodal competition in railway transport.



**RECOMMENDATION NO. 12**

**We recommend that the Minister of Transport commission a comprehensive study of the feasibility of separating railway operations from the ownership and maintenance of rail plant.**

The recent announcement by CP Rail of its intentions to abandon operations east of Sherbrooke, Quebec, raises the possibility of an early pilot project to test the common user rail plant concept.



**RECOMMENDATION NO. 13**

**We recommend that the Minister of Transport and the Agency explore the possibilities of making trackage in eastern Canada available for use by any rail carriers on a pilot project basis to test the common user rail plant concept.**

### *A Railway Monopoly*

Finally, there is the question of whether Canada really needs two transcontinental railway systems. Should we — can we — consolidate the existing system into one railway?

We did not find this solution attractive, since it does not allow for competition and could raise the spectre of reregulation. As we have noted, a more imaginative approach is needed to develop and sustain an adequate rail network for Canada in the 1990s and the next century.

### **Labour Productivity**

Railway labour productivity has improved in Canada, but not to the same extent as in the United States. In 1991, the productivity per employee at CP Rail was only 60% of the level achieved by the employees at seven leading U.S. railroads. CN employees stood at 56% of their U.S. counterparts.

It is not really meaningful to estimate what the savings would be to Canadian railways if they could achieve U.S. levels of productivity, as the traffic density, geography, topography and climate are very different in Canada. Nevertheless, if CN and CP Rail were to achieve the same productivity levels per employee as the seven leading U.S. railroads, there would be an annual reduction in labour costs of \$1 billion. Some of these savings would be absorbed by additional capital outlays.

A major cost of labour downsizing is associated with severance payments. In 1985 Canada's railways negotiated an employment security package with their railway shop craft and nonoperating employees who had completed eight years of cumulative compensated service. These employees are entitled to draw salary and benefits until they retire, provided that they continue to be available for work. Benefits on a similar scale are also available to railway employees in other trades. These job security packages were created when the railways did not anticipate the extent they would have to downsize.

In 1991, the cost to CN of employee separations amounted to \$94 million. CP Rail wrote off \$251 million in restructuring charges that same

year to cover severance payments and related expenses, although this amount covered several years. Severance payments of this generosity obviously erode the economies to be achieved by downsizing. This situation should not have been allowed to develop.

### **Labour Compensation**

The annual wage bill in 1991 for CN and CP Rail together was almost \$2.4 billion. The average weekly wage in the railway transport sector was \$841 in April/June 1992. The average weekly wage of someone in the trucking industry, before benefits, was \$565 — a 49% difference in earnings.<sup>24</sup>

If, on an admittedly arbitrary basis, this rail-truck wage differential were reduced from 49% to 35%, the labour expenses of Canadian railways would be reduced by some \$230 million per annum.

The question has arisen as to why railway labour compensation is so high. It may have been due in part, to the regulatory protection given to the railways over many decades, in part to the inability and/or unwillingness of railway management to countenance strikes, and in part to the speedy intervention of government on the rare occasions when strikes have occurred.

Government, railway management and shippers, all unwilling to face strikes, have played a part in this development.

### **Conclusion**

The challenge facing the government in pursuing a competitive agenda for the nation's railways is daunting. In terms of political pressure, it was somewhat simpler for legislators in 1987 to advance the interests of thousands of shippers against the voices of the railways as the legislation moved through Parliament.

It will be a much more difficult task to press for efficient railways in the face of decades of entrenched attitudes and the strong association between the presence of rail lines and the future of regions and municipalities.

However, we believe that the trucking industry and U.S. rail competitors pose a genuine threat to the future of Canada's railways and to the shippers who depend upon them. If Canada does not wish to pay the price of a serious deterioration of the rail mode in this decade, it is essential that the carriers be allowed and encouraged to make the changes needed to compete.

### MARINE CARRIERS

#### Background

Canada has a highly fragmented marine industry, with neither a national deep sea fleet nor a competitive international shipbuilding industry. Aside from the domestic movement of passengers and goods, Canada's maritime activities depend largely on developments beyond Canada's control.<sup>25</sup>

Maritime freight carriers operate on the Great Lakes, in the Arctic and in other inland waterways, and via Canadian coastal ports. They are only one part of a multifaceted marine industry that consists of ports, pilots, the Coast Guard, ferry services and other operations. Canadian domestic carrier operations are concentrated in the Great Lakes-St. Lawrence River regions. Apart from barge operators in the Arctic, these operations are not regulated under the *National Transportation Act*. However, their viability and that of associated industries and ports is affected by the reduction of grain exports from the St. Lawrence Seaway.

#### Canada and the International Maritime Fleet

While shipping has always played an important role in Canada's import and export trades, there has been no Canadian-domiciled international merchant fleet in more than 40 years.

In 1949, the federal government decided that it could not economically justify the maintenance of a Canadian flag fleet through subsidies and at taxpayers' expense. By 1950, costs and labour problems had ended the fleet's profitability, and Canadian shippers have since relied on more efficient

foreign flag operators for international cargo movements.<sup>26</sup> We see no reason to recommend changes to Canadian policy in this area.

### **Northern Marine Services**

Northern barge operators serve shippers, industries and settlements on the Mackenzie River, in the western Arctic regions, and on the Lake Athabasca system. These commercial operations are subject to provisions of the 1987 legislation. We found that those affected by the legislation in each region were generally satisfied with it.

Barge services in each of these regions are controlled by a dominant firm, with smaller enterprises offering complementary or competing services. These services provide the only economic form of transportation for bulk goods in remote environments. The declining resource industries, which are so intimately related to their transport operations, and increasing competition from surface and air transportation, have reduced carrier numbers from eleven to five in the last decade.

Limited port infrastructure and terminal facilities and a short season require operators to maintain large fleets if cargo requirements are to be met in their short operating seasons. This and the expense of high ice-class vessels, make regional shipping a costly and uncertain undertaking. Carriers work with aging fleets and government pressures to increase cost recovery for Coast Guard services. Profit levels have not warranted renewed vessel investment in the northern barge fleets.

We found, however, that the level and type of economic regulation affecting carriers are generally well received by stakeholders in the region. There were some problems identified with the *NTA, 1987*, but these represented concern with elements of the regulatory process and procedures and not with the rationale for economic regulation.

### Great Lakes Fleet

The commercial operation of Great Lakes fleets is not subject to any form of economic regulation. As a result, the viability of operators is determined by general economic activity within the region and the operators' overall competitiveness.

Significant competition is evident in the size and number of carriers. There are no legislative or regulatory barriers to entry, exit or level of service. Fleet operations are not directly subsidized by federal or provincial governments and Canada has no export cargo reservation laws. However, related services such as ice-breaking, canal operations, navigational aids and the operation of some ports are provided by the federal government on a less than full cost-recovery basis.

Since 1980, the fortunes of the Great Lakes fleet have declined significantly, reflecting problems in associated sectors such as grain and the domestic steel industry. Competition from other modes and regions has also reduced the demand for Great Lakes transportation services, and cost pressures are increasing. There has been a decline in the number of vessels (from 145 to 111) and operators (from 18 to 13) operating in the Great Lakes. The long-term outlook for these carriers is poor.

These trends have obvious implications for the many communities dependent on the Seaway, especially the Port of Thunder Bay, and for the enormous investments made in the Seaway and its ports.<sup>27</sup>

### INTERMODAL TRANSPORT

A significant development in North American freight transportation has been the increasing use of intermodal services, especially in import and export activity. Intermodal transport involves the moving of unitized freight, using two or more modes of transportation, in a continuous operation but under a single bill of lading or waybill.

Intermodal transportation is not explicitly covered in the *NTA, 1987*. However, a number of provisions in the Act have had a bearing on "intermodalism." Perhaps the most important, in terms of its impact on

intermodal transportation, has been the introduction of confidential contracts for railways.

CN and CP Rail have recently taken steps to expand their role in the North American intermodal market, particularly in an effort to counteract pressures from the United States.

The total revenue generated by intermodal traffic for CN and CP Rail in 1991 was \$745 million. Intermodal movements account for 6% of their railway tonnage and 13% of total revenue.<sup>28</sup> Trucking is heavily involved in the carriage of domestic intermodal traffic and may increase its participation in the offshore intermodal market.

Market forces from outside the country will continue to dominate developments in Canada's intermodal market. Over the next decade the intermodal transport systems in Canada and the United States will become increasingly integrated. This integration could pose a significant threat to Canadian intermodal operations. Canadian rail routes are largely east-west in orientation, so a shift to north-south flows will bring Canada's intermodal systems into greater competition with their U.S. counterparts.

In pursuing improvements to their intermodal services, rail carriers have had to overcome resistance from shippers, who were less than satisfied by the railways' previous service involving trailers and containers on flat cars. For example, a survey conducted in 1990

*[painted] a rather bleak picture for rail intermodal services in the movement of transborder freight. Rail intermodal has a poor reputation among many shippers, particularly in terms of service levels that it can provide. Significant service improvements combined with superior marketing efforts will be required if traffic volumes moving by rail intermodal are to increase measurably.<sup>29</sup>*

We believe that it is important to acknowledge the role of intermodal sector as a component of Canada's national transportation system and to acknowledge the need for carrier efficiency in providing intermodal services.



#### RECOMMENDATION NO. 14

**We recommend that intermodalism be recognized  
in the section 3 declaratory principles of the  
NTA, 1987 as forming an integral aspect of  
transportation policy.**

#### NOTES

- 1 This figure does not include private motoring. Car users paid some \$33 billion to cover the costs of private motoring in 1991. (*Summary Report of the Royal Commission on National Passenger Transportation*, November 1992, p.11.)
- 2 Carrier revenues from overseas trade are almost entirely earned by foreign-based companies and thus excluded from our analysis. Note that 1990 is the latest year for which Statistics Canada data are available, but modal shares have remained much the same since 1990.
- 3 This is why, in tonne-kilometre terms, rail is the most important freight mode; its average length of haul is much greater than that of trucking.
- 4 Revenue per tonne-kilometre for the trucking industry was 10.0 cents in 1989, against 2.4 cents for rail (Statistics Canada 53-222 and 52-216). However, this does not reflect rate differences, because type of product and length of haul differ between the modes.
- 5 The intercity bus industry is not considered since it was examined by the Royal Commission on National Passenger Transportation.
- 6 The 1988 RTAC Agreement resulted in increasing gross vehicle weights in several jurisdictions.
- 7 F. Nix, *Motor Carrier Transport Study. The Impact of Weight and Dimension Regulations on Trucking*, p.iii.

8 Revenue Canada data show 39 companies leaving the industry in 1990. This contrasts with Office of the Superintendent of Bankruptcies' reports of 656 bankruptcies in 1990, and 763 in 1991. The latter figures, however, include many unincorporated trucking entities, and represent failures of owner-operators rather than trucking companies.

9 The Canadian Trucking Association (CTA) recommends that the fitness test include evaluation of a business plan and follow-up by regulatory bodies to ensure adherence to the plan. The Canadian Council of Motor Transport Administrators (CCMTA) contemplates a fitness test limited to safety elements. Shipper groups favour a safety-oriented test; there is limited support for evidence of financial responsibility but not for business-plan assessments.

10 For example, Canadian provinces east of the Manitoba/Ontario border prohibit 16.2-metre (53-foot) semitrailers, standard elsewhere in North America, restricting length to 14.6 metres (48 feet). Eastern provinces also restrict overall vehicle combination length to 23 metres, as against western Canada's 25-metre restriction. The adverse consequences of these differences are well documented in our research.

11 The Gough & Gray Group, Inc., *A Comparison of Canadian and U.S. Carrier Management Approaches*, p.3.

12 For the industry as a whole, the debt/equity ratio was 66/34 or slightly better than on December 31, 1987. Air Canada had improved its debt/equity ratio to 59/41 while Canadian Airline International's debt/equity ratio was 70/30.

13 \$146 million cash, \$105 million in PWA common stock, and the assumption of over \$300 million of Wardair debt.

14 Revenue passenger kilometres (RPKs) is an output measure of scheduled air carriers in respect of passenger traffic. As an example, the carriage of 100 passengers over a distance of 1,000 kilometres generates 100,000 RPK.

15 One example of the hub and spoke system is illustrated by American Airlines' hub service. In this system, Chicago serves as a hub for east-west flows along the northern half of the nation; Dallas plays a similar role for the southern half. Nashville serves primarily traffic moving between the midwest and the southeast while Raleigh-Durham processes north-south traffic moving along the eastern seaboard. Miami and San Juan are important interfaces between domestic, regional Caribbean and international services.

16 Statistics Canada 51-204, Air Passenger Origin and Destination Domestic Report.

17 For example, a European carrier with an interlocking share ownership with a U.S. carrier may choose to undertake major overhauls of its fleet in the U.S. because of lower labour costs.

18 Air Transport World, "Aiming for a Global Carrier," 9-92 pp. 45-6.

19 SH&E Presentation to Airports Consulting Council, November 1992.

- 20 Investment Canada reviews acquisitions for control (in excess of \$150 million from U.S. investors or in excess of \$5 million from investors from non-U.S. countries) of Canada businesses by foreign investors. Reviews of acquisitions are to ensure that they are likely to be of net benefit to Canada.
- 21 The basis of the calculation is not self-explanatory. In 1990, CN and CP Rail together had railway assets equivalent to 190% of operating revenues. If the operating ratio were 80%, 20% of operating revenues would be available as a return on assets. Expressing 20% of operating revenues as a percentage of assets equivalent to 190% of operating revenues, the return on assets becomes 10.5%.
- 22 In the usual course of abandonment applications, lines found to be in the public interest are not ordered abandoned. Consequently, this subsidy would not become available.
- 23 The *NTA, 1987* requires railway line purchasers to assume the selling railway company's obligations to Via Rail Canada Inc. There is no opportunity provided to renegotiate that arrangement. A conveyed line on which Via Rail has running rights is automatically declared statutorily to be for the general advantage of Canada. These provisions may make the purchase of railway lines, on which Via Rail operates, commercially unattractive. Purchasers should be able to bargain freely with Via Rail or any other railway company over running rights. This recommendation does not prevent the Agency from assuming ownership of an abandoned line if public interest criteria are extended to include essential passenger rail services. However, the expense of keeping railway lines open for passenger services should be set through a public tender process and not by statutorily forcing the cost of this obligation on potential purchasers.
- 24 Calculations from IBI contract research for the Commission and Statistics Canada 72-002.
- 25 The *Shipping Conferences Exemption Act* has no impact on Canadian carriers, since there is no Canadian flag fleet operating in deep-sea trades.
- 26 Although a number of Canadian deep-sea ship operators remain and handle significant amounts of Canadian exports, they do not employ Canadian-registered vessels or crews, as the expense would be prohibitive in international terms.
- 27 In July 1992, a Seaway Round Table was established under the aegis of the Minister of State for Transport to explore the present status of the Seaway in respect of the implications of grain transportation policy. All stakeholders were represented and a Final Report was released on November 4, 1992. This is currently being considered by federal and provincial ministers.
- 28 The total volume of CN and CP Rail intermodal traffic 1991 was 12.2 million tonnes, generating 23.6 billion tonne kilometres. The export-import component is by far the most important one of the three main categories of traffic (export/import, domestic, transborder), ranging in recent years from 45 to 50% of total intermodal tonnage carried by the two railways.

The total volume of export/import container traffic handled at Canada Ports Corporation ports in 1991 amounted to 12.6 million tonnes. Containerized traffic was 7% of total cargo tonnage, but 25% of port revenues. The ports of Halifax, Montreal and Vancouver handled over 96% of containers moving through Canadian ports.

The proportion of Canada containerized traffic moving through U.S. ports has been fairly constant since 1988 and was 20.5% in 1991. The total volume of diverted cargo amounted to some 2.3 million tonnes. However, in 1991, 2.7 million tonnes of U.S. cargo was also diverted via Canadian ports, giving Canada an overall positive net balance of some 400,000 tonnes.

- 29 Since the release of the report, CN has commenced work on a new double stack tunnel between Sarnia and Port Huron. As well, the CN/CP Rail tunnel between Windsor and Detroit will be undergoing an enlargement to handle all types of intermodal equipment with the exception of double stack cars and automotive frame cars.





## 5

# The Challenge of Keeping Competition Alive

### INTRODUCTION

In the previous chapter we looked at how the *NTA, 1987* has affected the transportation industry itself — the carriers. In this chapter we examine the Act to see whether it promoted or reduced competition among carriers for customers, and whether customers in turn derived any benefits or suffered any harm from the changes in competition brought about by the Act.

Indeed, the purpose of the Act is to ensure that travellers and shippers are well served by a healthy, competitive and responsive transportation industry, as well as to provide an equitable and competitive environment for carriers.

In general, healthy competition among carriers brings benefits both to their customers here in Canada — who have access to lower prices, better service and more choices — and to the carriers themselves, who will be better able to compete internationally. But for governments, the maintenance of competition is an elusive goal. For reasons already discussed,

Association of International  
Automobile Manufacturers of  
Canada

*"We submit that the realities  
of competition in a North  
American marketplace are  
already upon us, and Cana-  
dian carriers must be given  
the opportunity to compete  
in this marketplace on an  
equal footing...."*

governments face continuous pressure applied by existing operators, their employees and dependent suppliers to limit competition. The definition of adequate competition is far from clear. It can be affected by events in other modes or jurisdictions. In the following sections of this chapter, we will consider each of the modes of transport in turn, to see to what extent the Act has been successful in promoting competition. We have also made recommendations on how it might be improved.

## TRUCKING

### Regulatory Reforms

The *Motor Vehicle Transport Act, 1987* removed the requirement that a company seeking to enter extraprovincial trucking must prove to provincial highway boards that its service was in the interest of "public convenience and necessity." In its place, prospective entrants now need only meet a fitness test. However, during the first five years after the Act came into effect, a licence could be denied if opponents proved that to grant it would be contrary to the public interest. The Act also eliminated the regulation of extraprovincial rates and left the administration of the new rules with the provincial boards.

### Results

Different provinces have applied the public interest test in different ways. Some provinces, including Alberta and Quebec, have granted virtually all extraprovincial licences. These same provinces are also liberal in granting licences for trucking within the province. Manitoba, however, has sometimes denied extraprovincial licences to qualified carriers and continues to control new entries into provincial trucking, as do Saskatchewan and British Columbia. In 1991 Ontario suspended the granting of new licences for intra-provincial trucking for two years.

As indicated in Chapter 4, the trucking industry has become more competitive, more responsive to its customers and more efficient. Even the

restrictions on entry in some provinces have only slowed, but not stopped, these improvements.

### Conclusions and Recommendations

We believe that the regulatory reforms of the *Motor Vehicle Transport Act, 1987* have generally led to more competitive prices in the trucking industry without compromising service. In surveys conducted by the National Transportation Agency, shippers have consistently judged the overall quality and efficiency of trucking services as good or very good.

Further improvements in competition, service and efficiency have been slowed, however, by the difficulty in some provinces of entering the industry. The provision of the Act that allowed a licence to be denied if deemed contrary to the public interest expired on January 1, 1993. We believe that this provision served its purpose and that no extension of it was necessary.

Because this provision was not extended, a carrier's fitness will now be the only standard for licensing extraprovincial trucking. The Administrators of the Canadian Council of Motor Transport Administration are currently developing a uniform fitness test and standards of safety.

Some groups, however, would like to see fitness judged more broadly and to take into account the carrier's financial resources and the business knowledge of the prospective entrant. The Canadian Trucking Association, the British Columbia Trucking Association and the Ontario government have all proposed a broad test of fitness that would include evaluating an applicant's business plan. The proposed measure would require an applicant to discuss the markets and customers the applicant intends to serve and the means by which a safety program would be financed.

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Atlantic Provinces  
Transportation Commission

*"The legislation relaxing controls on the trucking industry is arguably the single greatest factor in contributing to the tremendous increase in competition in the transportation industry since 1988."*

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In our view, such broad tests of fitness would simply reimpose the regulatory control over extraprovincial trucking that the Act sought to lift. We are opposed to such broad tests because they would not only jeopardize the gains in price and service increasingly enjoyed by shippers but would affect the competitiveness of the Canadian trucking industry in a free North American market.

We would like to see a standard test of fitness, limited to matters of safety, uniformly enforced in all provinces and applied to existing as well as to new carriers.



#### **RECOMMENDATION NO. 15:**

**We recommend that there be a uniform fitness test in all jurisdictions and that its objectives be limited to screening out unsafe and uninsured operators.**

### **AIR**

#### **Regulatory Reforms**

The *NTA, 1987* ended the regulation of the domestic airline industry in southern Canada. Airlines can now choose which routes to fly and what fares to charge. New carriers may enter and exit the market without restriction. In northern Canada, however, the *NTA, 1987* still regulates the industry. The entry of a new carrier may be challenged, though the onus is on the challenger to prove that service to the region would be impaired. Although fares are not regulated, basic economy fares in the north can be reduced by the National Transportation Agency if, acting on a complaint, they find the fares unreasonable.

## Results

Before regulatory reform began in Canada in the 1980s, there was little competition within the airline industry. Air Canada dominated the market, and few routes had more than one carrier. Now, while service has increased substantially, with more flights to more Canadian cities, and fares for international flights and for flights in general have fallen, since 1988 the prices of domestic flights have gone up. Air Canada, Canadian Airlines International and their affiliates match fares, including discounts fares, schedules, frequent-flyer plans, and other services, so that Canadian travellers now have a choice of carriers and comparable service on many routes. But these improvements have not come without a price. Both Air Canada and Canadian Airlines International are losing money, and the future of the airline industry in Canada is, at this moment, uncertain. If one of these carriers should fail and its service be discontinued, consumers could be seriously affected and various regulatory provisions, unless changed, could limit the growth of competition from charters or foreign carriers.

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Canadian Airlines International

*“Canadian Airlines submits that, under the current legislation, vigorous competition has had an opportunity to develop in Canada with reasonable fares and a high level of service.”*

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## Conclusions and Recommendations

In the preceding chapter we focussed on the shape of the Canadian airline industry and the government approach which would foster its development. Paradoxically, with a view to sustaining competition and the benefits that result, we have considered proposals which would allow the world's most powerful carriers to establish operations in Canada. These proposals would have significant implications for Canada's ability to maintain a Canadian owned airline industry.

### *Domestic Service*

Today's air passenger service market is dominated by the duopoly of Air Canada and Canadian Airlines International. Together with their affiliates, they command over 90% of the scheduled market and at least 25% of the air charter market. Given the market power that frequent-flier programs and computer reservation systems provide the current carriers and their dominance of major markets, the prospect of new entrants establishing themselves in the system is questionable.

The behaviour of the duopoly has caused inefficiencies in the form of excess capacity and higher prices for domestic travel. The future of the carriers is in jeopardy and, with it, domestic competition. We believe that the government should focus its efforts on maintaining competition and consumer choice. We recognize that this requires some difficult choices.

In order to maintain competition within Canada, we encourage the government to allow more foreign investment in Canadian airlines. In the event of a monopoly or collusive duopoly, we further encourage the government to allow foreign carriers to serve the domestic market, or to allow foreign carriers to establish Canadian operations. A detailed summary of a number of proposals which we have considered and which would accomplish the goal of maintaining competition is contained in Annex A of this report. We have found only two of the proposals worthy of future consideration, and out of them recommendations arise.

### **Proposal 1: Relax the Foreign Ownership Limit**

Under this option, Canada would raise the 25% ceiling on foreign equity participation in a Canadian airline. Relaxing the ownership rule is unquestionably a pro-competitive measure. It would provide all Canadian airlines, existing and potential, with greater access to capital.



#### **RECOMMENDATION NO. 16**

We recommend that the definition of "Canadian" in section 67(1) of the *NTA, 1987* be amended, or that the federal Cabinet exercise its present power contained in that definition, to alter the percentage of voting interests in air carriers owned and controlled by Canadians from 75% to 51%.

#### **Proposal 2: Foreign Carrier Cabotage or Right of Establishment**

Under this proposal, foreign airlines would be permitted to carry passengers between Canadian points, or to establish stand-alone, intra-Canada operations. The latter could be operated either by the airline itself, a separate division, or a subsidiary. Because the permanent establishment of foreign carrier operations or routes could adversely affect Canadian operators and investors, this option should be exercised with great care.



#### **RECOMMENDATION NO. 17**

We recommend that, should restructuring in the domestic airline market result in a primary carrier monopoly, the federal Cabinet give policy directions to the Agency under section 23 of the *NTA, 1987* to license the granting of traffic rights within Canada to foreign carriers, or to permit foreign carriers to establish operations within Canada.

*International Protectionism*

Despite deregulation in the U.S., airlines worldwide remain highly regulated. International air travel is governed by bilateral agreements between countries, foreign ownership is strictly limited, many airlines are either state-owned or subsidized and fares and routes are often set by governments. Airlines for their part are seeking to expand their foreign markets through networks, alliances and mergers with other airlines.

The airline industry is changing. As carriers form international alliances and global networks, the central importance of a national airline is passing away. The government has indicated that it is willing to liberalize its bilateral arrangements with the U.S. The future of competitive domestic air travel in Canada may well lie in policies that help Canadian carriers compete in the new international markets, but such policies should never be adopted at the expense of the Canadian traveller.

Certain restrictions in the Air Transportation Regulations delay possible use by air carriers of other carriers' seating space or aircraft in servicing proposed alliance routes economically.<sup>1</sup>

**RECOMMENDATION NO. 18**

We recommend that the federal Cabinet give a policy direction to the Agency to expedite its procedures for review of carrier applications concerning block space and code sharing arrangements.

**RECOMMENDATION NO. 19**

We recommend the liberalization of Canada-U.S. air bilateral arrangements.

The present process for bilateral air transport agreements limits market expansion of international air transport to the size of the two negotiating countries' internal markets. The Chicago Convention concept of the national carrier is being outdated rapidly by economic events.

As we have commented extensively in Chapter 4, we believe the bilateral process, while useful in the Canada-U.S. context, has only limited longer-term value for Canada. Future progress will be achieved only through adoption of a more liberalized and multilateral arrangement that builds on GATT trade principles.<sup>2</sup> We foresee substantial competitive potential in this process.



#### **RECOMMENDATION NO. 20**

**We recommend that the Government of Canada take  
the initiative now to lay the necessary groundwork  
for the development of multilateral trade  
agreements in air services.**

#### *Freedom of Entry*

Air traffic capacity at many of the world's airports is a crucial problem. When demand exceeds the airspace capacity and/or airport infrastructure capacity, delay results. This inevitably leads to slot allocation programs that replace the formula of "first come, first served." There are many parties with considerable financial and political interests at stake in the slot allocation schemes. Since many of the world's airports are now near their capacity, how slots are allocated to airlines is crucial. If slots are simply sold, then the larger, more

established carriers would have an advantage over smaller and newer entries. What is more, the cost of these slots would then be passed on to the traveller in the form of higher fares. In general, we favour a system of allocating slots at Canadian airports that recognizes the precedence of established airlines but at the same time makes new entries possible.



#### **RECOMMENDATION NO. 21**

**We recommend that the Minister of Transport develop now a procedure for slot allocation, with common entry criteria, for use at airports which face capacity restrictions in the future.**

#### *Designations*

Lack of access to international routes can be a significant barrier to the entry of an air carrier. This issue may take on added significance as international alliances become important elements of carrier strategy.

Carriers are designated by the government to fly routes negotiated between Canada and other states. It is essential that the government, in making an international designation, provide access to multiple operators and not encourage monopoly control of these routes. For this reason, we do not support the concept of designations as a saleable or transferable asset of a carrier. Recent history has demonstrated that the use of these designations can be an important tool in the promotion of competition. This is especially important at a time when the Canadian market is moving toward concentration and possible monopoly. International designations could fall entirely into

the hands of a monopoly carrier, and the government would face difficulties in reclaiming control over these assets.



#### RECOMMENDATION NO. 22

**We recommend that the *Aeronautics Act* be amended to confirm that:**

- a) International air routes are public property; and
- b) The Minister of Transport shall publish criteria for making designations of international air routes. These criteria should discourage designation in the context of any dealings between Canadian carriers respecting payment for shares or assets which are conditional upon the conferral of a designation and which would have the effect of preventing or unduly lessening competition.

Where *charter airlines* have offered competition, scheduled airlines have been forced to lower fares. Many of those we consulted, however, believed that charter airlines offered less competition than they could because of the Air Transportation Regulations governing them. The purpose of these regulations is to distinguish charter from scheduled airlines by requiring minimum stays and round trips, and by limiting transfers of tickets and changes in reservations. These regulations were introduced well over a decade ago, when scheduled airlines were thought to need protection from charters.

The Minister of Transport has asked the National Transportation Agency to review the rules governing charters that relate to the current bilateral negotiations between Canada and the U.S. We believe, however, that a

more general review of Air Transportation Regulations is required. If charters are to compete effectively with scheduled airlines, they must be allowed to operate under the same conditions.



#### RECOMMENDATION NO. 23

We recommend that the federal Cabinet provide a policy direction to the Agency to prepare amendments to the Air Transportation Regulations relaxing restrictions on contracting and administrative procedures relating to air charter services.

#### *Continued Economic Regulation*

In our consultations we heard different views on the provisions of the Act dealing with *northern air service*. Some believed that the regulation of northern air services was not consistent with the general emphasis in the Act on market forces. They felt the provisions should end. Others would like to see new programs that would ensure adequate air service to northern communities. In general, air service in the north has improved since 1987. Better and more frequent service has come to some communities from the regional affiliates of the national airlines, and while service to some other communities has declined, none has lost air service entirely.

As a result, we do not see any need for a new and possibly costly program of government intervention. However, nor would we suggest that the provisions in the Act for air service in northern Canada be eliminated. More time is needed to ensure that the north has adequate air service in the future, especially given the current uncertainty within the domestic airline industry.

**RECOMMENDATION NO. 24**

**We recommend that the provisions of the *NTA, 1987* applying to northern air services be retained and that the Minister of Transport review the continued need for these provisions within five years.**

**RAIL****Regulatory Reforms**

The purpose of those provisions of the *NTA, 1987* that concern rail transport is to encourage competitive behaviour among the railways. The Act abolished the right of railways to set their rates collectively, allowing them more freedom in setting rates and allowing them to enter into confidential contracts with shippers.

Where there is little or no real competition to a single railway, the Act also sought to encourage competitive behaviour. For instance, shippers of bulk commodities such as lumber, coal and potash are often served by only one rail line, and either have no access to other modes of transport or these modes are not economical for them. In such cases, the Act sought to encourage competitive behaviour with two main provisions. First, it extended the limit of interswitching — the maximum distance within which a railway must switch the freight cars of its competitors — from 6.4 kilometres (four miles) to 30 kilometres. Second, it introduced the provision of competitive line rates, by which a railway, at the request of a shipper, must quote a rate to transport goods to a competitor's line. If the railway and shipper cannot come to an agreement on the rate, the rate will be set by the National Transportation Agency.

In addition to these provisions, the Act gave the National Transportation Agency the power to mediate or arbitrate disputes between shippers and carriers.

## Results

The general result of these regulatory reforms has been a more competitive environment in rail transport. The price of shipping a tonne of freight has fallen in real dollars since 1987, although some of this fall must be attributed to increases in the productivity of railways and some to the recession and the resulting fall in demand for transport.

Shippers generally agree that the confidential contracts that they can now make with railways result in customized agreements that better meet their needs. Approximately 70% of all non-grain traffic is now serviced under confidential contracts, and it is clear that this mechanism is now working effectively. We regard confidential contracts as one of the most successful innovations of the NTA, 1987. The changed commercial relationship engendered by confidential contracts has proved beneficial to the whole bargaining process and has produced a better understanding by shippers and carriers of each other's problems.

However, we see little reason to require carriers to continue filing these contracts with the Agency.

### Inland Cement Limited

*"We believe that since the advent of the NTA, 1987, the railways have sought and, in some measure, achieved efficiencies that may have been unthinkable only a few years before."*

### Alberta Department of Transportation and Utilities

*"As long as railways have high fixed and declining unit costs, the easy entry, highly competitive trucking model for transport deregulation cannot fully apply.*

*Railways cannot mirror motor carrier pricing without the same relatively constant unit costs independent of volume. Thus, while innovations in regulation may be possible, some legitimate basis remains for regulation: to reduce cost and increase the scope for competition."*

**RECOMMENDATION NO. 25**

We recommend that the *NTA, 1987* be amended to repeal the requirement that copies of confidential contracts be filed with the Agency. Carriers should be required to retain copies of such contracts on file for six years.

Shippers have responded positively to the extension of the inter-switching distance from 6.4 kilometres (4 miles) to 30 kilometres. A survey by the Canadian Manufacturers' Association shows that the percentage of shippers having access to two or more railways increased from 54% to 80% following the introduction of extended interswitching limits. The number of cars switched by CN and CP Rail has approximately doubled. Shippers reported to the National Transportation Agency that extended interswitching rights increased their bargaining position in negotiations with the railways.

Competitive line rates (CLRs) — or the provision of the Act which requires a railway to set a rate for transporting goods to a competitor's line — have proven to be more controversial. The railways have opposed them from the beginning, seeing them as an unwarranted intervention in the market. They have argued that the CLR is not required since it is not in the railways' interests to force shippers out of business. The railways would prefer that, where there is no competition, shippers be protected by a maximum rate relief mechanism similar to the one used in the United States. The Agency argues that these measures are cumbersome to administer. They are a disadvantage to shippers, who have to prove there is no other way to ship their goods and that the rate they are being offered is unreasonable.

CLRs are intended to benefit shippers who are on only one rail line, who are outside the interswitching limit and whose goods cannot profitably

be shipped by truck. Rail transport is often the only way to move bulk commodities of low value, such as coal, over long distances over land. In such cases, a railway has no effective competition and commands considerable market power.

Shippers are also concerned about the expected increase in the number of short line railways. These operations fall under provincial jurisdiction and are not governed by federal legislation that encourages competitive behaviour between the national railways.

### **Conclusions and Recommendations**

In general we have found that the *NTA, 1987* has encouraged more competition among the railways and more competitive behaviour. But we have also found that there are serious concerns about some provisions of the Act, particularly the competitive line rate and final offer arbitration provisions.

#### *Competitive Line Rates*

Review of sections 134-142 of the *NTA, 1987* was one of the most difficult issues facing this Commission.

The provisions are a paradox. They offer intrusive regulatory devices in legislation intended to reduce regulatory burdens. They include tribunal mechanisms in legislation that seeks to put business relationships out of the reach of government.

The paradox continued through this comprehensive review. No issue inspired more intense debate than the CLR provisions, and yet there are few examples of them actually being used. Only three shippers have applied for CLRs since 1987, and no party appearing before us could demonstrate that the provisions had a clear economic effect.

Yet many shippers said that CLRs were the most important feature of the Act, and some submissions dealt with little else. While both railways called for changes to weaken these provisions, they, too, failed to prove that the provisions had significant economic effects.

For a time we contemplated making no particular comment on these provisions, since it is clear that, while real evidence is lacking, powerful emotional responses are not. We were concerned that the issue would polarize a community which urgently needs co-operation to face the challenges ahead. However, our mandate and the many proposals made to us makes a response necessary. Philosophical arguments aside, some aspects of the CLR mechanism simply do not work and should be improved.

Under section 266(3)(j), the Commission was instructed to address the effects of competitive line rates “on the revenues, financial viability, capital investment and service level of railway companies.”

At the present time, there are no CLRs in operation, and those that were in place accommodated shippers using U.S. railroads. They have been allowed to lapse. CN and CP Rail have effectively declined to compete with each other through CLRs, and as a result the provision is largely inoperative in Canada. Given the limited utilization of CLRs, no convincing evidence has been found by the Commission to indicate any substantial effects from CLRs on railway revenues, viability, investment and service levels.

As we have stated previously, we generally feel that the Act’s most significant achievement was to secure reduced costs for shippers. These gains must be protected. Amendments to the CLR provisions should not reverse this achievement. However, we can also imagine a time when rationalization might create a greater dependence on this mechanism and the flaws we perceive could become significant issues. Therefore, we have considered a wide range of proposals and arrived at a short list of refinements that we feel would make the Act fairer or simply more functional.

A summary of the CLR proposals we considered and our thoughts in respect of each one can be found in Annex B.

As a consequence of this debate, recommendations follow:



### RECOMMENDATION NO. 26

We recommend that the *NTA, 1987* retain competitive access rights, with the following modifications:

- a) Section 142 be repealed and section 137 be amended to require that the Agency establish CLRs that are commercially fair and reasonable (i.e., CLRs that match the revenue that the local carrier would have achieved under intramodal competition).
- b) Section 134 be amended to require that
  - i) in applying for a CLR, the shipper disclose if its designated route has a factitious destination; and that
  - ii) on such disclosure being made, the Agency disregard the amount of the connecting carrier's rate in establishing a CLR.
- c) The words "unless the containers arrive at a port in Canada by water for further movement by rail or by rail for further movement by water" in section 135(3) be repealed;
- d) Section 135(6) be amended to provide that CLRs for a routing through Canada may be set for both origin and destination points if both shipper and consignee are captive to the same railway company;

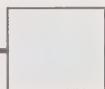
- e) Section 139 be amended to provide that on an initial application for a CLR, the Agency may set a CLR for a period of up to three years if the shipper proves a demonstrable need for a CLR longer than one year; and
- f) Section 140(1) be amended to clarify that the carrier on which a CLR is imposed is not required to supply cars for the traffic being moved.

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#### *Final Offer Arbitration*

The 1987 legislation gave the Agency an expanded role in mediating and requiring arbitration of disputes arising out of disagreements over rates and conditions. This reflects a growing interest in alternate dispute resolution as a means of speeding decision making and reducing delays and expense. Participation by carriers or shippers in mediation is voluntary. Final offer arbitration (FOA) applies to the carriage of goods by rail and air. In FOA, both shipper and carrier submit their final best offer in writing and the arbitrator must choose between the two. The arbitrator's choice is final for one year, unless shipper and carrier agree to extend the arrangement.

As in the case of CLRs, the FOA issue was addressed in a number of submissions and inspired debate, although few shippers have used the provision. We are of the opinion that FOA can be very useful as a competitive tool, but, for reasons outlined in Annex C, we believe modifications are necessary.

**RECOMMENDATION NO. 27**

We recommend that the arbitration provisions of the *NTA, 1987* be amended to:

- a) Repeal the alternate investigation procedure and substitute a summary process in which a carrier has the responsibility of demonstrating to the Agency that effective competition exists;
- b) Require the Agency to refer the dispute to final offer arbitration (FOA) upon a finding that effective competition does not exist;
- c) Require the arbitrator to determine whether either offer is commercially reasonable, and,
  - i) where both offers are commercially reasonable, require the arbitrator choose between them; or
  - ii) where one offer is determined not to be commercially reasonable, require the arbitrator to select the other offer; or
  - iii) where both offers are determined to be commercially unreasonable, require the arbitrator to determine and set a commercially reasonable rate.
- d) Require the Agency, after conducting public consultations, to publish and periodically revise criteria for establishing the existence of an effective competitive market and for determining commercially reasonable rates.

### *Compensatory Rates*

Under the Act, as was the case before its passage, a railway may not charge a rate that is less than what it costs to move the goods. This was to prevent the railways from lowering prices in order to drive competitors out of business. The National Transportation Agency must disallow such rates. Of the five cases of noncompensatory rates that have come before the Agency since 1988, none has been shown to have been intended to lessen competition or harm a competitor. Nevertheless, the Bureau of Competition Policy has suggested that this provision has sometimes caused the railways to set higher, less competitive rates for fear of provoking an inquiry. This puts the railways at a disadvantage in relation to other modes of transport that are not subject to this regulation.

Some parties who raised this issue favoured an end to the regulation of compensatory rates, while others feared that, if the regulation was abolished, railways would raise rates for captive shippers in order to recoup losses from below-cost rates in very competitive markets. CP Rail, for one, expressed concern that CN, as a Crown corporation, might use its access to public funds to offer rates below cost.

We believe that these concerns are not justified. The *Competition Act*, which now extends to Crown corporations such as CN, offers adequate protection against predatory pricing and the abuse of dominance in a market. The *Competition Act* has the advantage of applying equally to railways and to all other forms of transport. We also believe it unlikely that a railway would use such tactics to reduce competition from trucking companies. The railway would face immediate competition from trucking firms as soon as it raised its prices again.

We thus see no reason to maintain the provisions of the Act concerning compensatory rates.

**RECOMMENDATION NO. 28**

**We recommend abolition of the compensatory rate provisions of section 112 and section 113 of the NTA, 1987.**

### *Short Line Railways*

As larger railroads in the U.S. rationalized their routes, many short line railways sprang up to provide service on track that would otherwise have been abandoned. With their lower labour costs and higher productivity, short line railways have proven to be very successful. In Canada, short line railways have been slower to develop, in part because of institutional impediments that we discussed in Chapter 4. We believe that short line railways should be encouraged in Canada as a way of enhancing competition.

### **MARINE**

#### **Regulatory Reforms**

Since the first *Shipping Conferences Exemption Act* (SCEA) was passed in 1971, shipping conferences, which are associations of international ocean carriers, have been allowed to regulate the rates, ancillary charges and other terms and conditions of operation of their members. These are collective activities which would be otherwise prohibited by the *Competition Act*. Parliament, while retaining this exemption, also sought to encourage competition in several ways. Members of conferences are now allowed to set rates and offer services independent of those set by the conference. They cannot, however, freely make confidential contracts.

Isolated communities on the Mackenzie River (including those on the Delta and the western Arctic coast) and Lake Athabasca, which are heavily dependent on water transport for their supplies, have been protected

since 1945 by regulations governing shipping. These communities are still protected under Part V of the current Act governing Northern Marine Resupply Services. All carriers with fleets larger than 50 tonnes must be licensed to supply these communities, and their tariffs must be published and filed with the National Transportation Agency. Previously, these rates had to be approved; now, they are merely filed with the Agency. The Act also removed regulations on some cargoes (including defence cargo and exploration and mining supplies) and simplified the licensing of carriers.

## Results

In general, we have found that the effects of the reforms introduced by the *SCEA, 1987* have been much less than anticipated. This is partly because the shipping industry has changed over the last five years, and shipping conferences no longer have as much impact as they once did. The number of conferences serving Canada has fallen considerably. In 1988, conference liners carried 48% of the outbound tonnage. And in 1989 and 1990, independent lines offered as many or more weekly services than conference carriers.

At the same time, the National Transportation Agency has observed that the rates set by conferences for a number of major commodities are now below 1983 levels and that service has improved since 1988. These changes are the result of a depressed shipping market and more competition from independent liners.

Because of the general increase in competition and the decline in the importance of the conferences, the provisions of the Act to encourage competition within conferences have not been extensively used. The provision for service contracts has apparently been used even less. The National Transportation Agency suggests that cargo moved under service contracts is only a very small proportion of the total moved by conferences.

On the Great Lakes, competition in shipping is stiff. Thirteen companies compete for a share of the market, with the bulk fleet operating at only 40% of capacity. These carriers must compete not only with each other but also with U.S. railroads; with increasingly aggressive Canadian railways,

which offer train service from the mid-west to the eastern tidewater; and with the nationally supported Mississippi River system, which, unlike the St. Lawrence Seaway, is toll-free.

### Conclusions and Recommendations

The exemption of shipping conferences from the prohibitions against the collective setting of rates runs counter to the general policy of encouraging competition. The Act legitimizes a cartel, and, unlike the situation in all other transport modes, shippers are unable to negotiate freely with individual carriers who are members of a conference. Canadian shippers are unhappy with the exemption and disappointed with the limited success of the 1987 reforms. Shippers in Europe and the U.S. are also dissatisfied with current conference practices.

In principle, we are opposed to the intent of the *SCEA*. It is clearly in conflict with the overall competitive thrust of the *NTA, 1987*. While we cannot find evidence that the conference exemption has had significant economic impact, we are sympathetic to the comment of one shipper who described contract negotiations with a cartel as "a hell of a way to do business."

However, we believe it would be unwise for Canada to end these exemptions now. This action might cause uncertainty in the industry until the jurisdiction of Canadian law and the application of the *Competition Act* are tested in the courts. Members of conferences might also turn to U.S. ports, harming Canadian ports and Canadian carriers. Since independent lines are effectively competing with conference lines, there is no compelling reason for Canada to act alone.

We believe that international action is appropriate here. Canada should not repeal the *SCEA* until the U.S. and its trading partners are willing to act in concert.<sup>3</sup>

We would encourage the government to persuade the international community to bring shipping conferences under competition law.

Meanwhile, the *SCEA* should be amended in two ways. First, conferences should be allowed to negotiate with inland carriers for through freight

rates. The railways would gain by having assured revenue, which would lead to lower costs for shippers and receivers. Canadian ports would also gain, since they would be guaranteed a base cargo throughout. Second, the notice time for independent action on rates should be reduced from 15 days to 10 days, to encourage more carriers to set independent rates.



#### **RECOMMENDATION NO. 29**

**We recommend that the Minister of Transport introduce legislation to repeal the *SCEA* at such time as United States antitrust immunity for shipping conferences is withdrawn.**

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#### **RECOMMENDATION NO. 30**

**We recommend that the federal Cabinet reduce to ten days the notice period for independent action by shipping conference members.**

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#### **RECOMMENDATION NO. 31**

**We recommend the Minister of Transport introduce amendments to section 5 of the *SCEA* to permit shipping conferences to contract for and quote through freight rates for precarriage or onward land carriage.**

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According to surveys conducted by the National Transportation Agency, shippers and carriers alike are largely satisfied with the regulation of supply services to northern communities through the provisions of Part V of

the Act (Northern Marine Resupply Services). All agree that water transportation should continue to be regulated to ensure adequate service now and in the future. Shippers were generally satisfied with the service they received, and although carriers were sometimes dissatisfied with certain procedures involved in regulation, they were generally favourable toward the Act.

We believe, therefore, that regulation answers the needs of shippers and carriers in the Mackenzie region and on Lake Athabasca and that it should be retained. In five years it should be reviewed again.



#### **RECOMMENDATION NO. 32**

**We recommend that Part V of the *NTA, 1987* be retained and that the Minister of Transport review the continued need for such regulation within five years.**

#### **INTERMODAL SERVICES**

Intermodal transport, which includes containers and trailers that can be moved by truck, rail or ship, is an increasingly attractive mode to shippers who seek door-to-door or point-to-point service. In surveys done by the National Transportation Agency, the number of shippers using intermodal services increased from 37% in 1988 to 45% in 1991.

The intermodal service sector is very competitive. Canadian intermodal carriers compete with other domestic and international carriers and also with standard truck, rail and marine carriers. In the north Atlantic, the container ports of Montreal and Halifax must compete with U.S. ports such as New York, Philadelphia and Baltimore.

Partly because of the high level of competition, rates for intermodal transport have risen only modestly in recent years. At the same time, new services and technologies are being introduced, such as double stack containers and the RoadRailer which was introduced by CP Rail in co-operation with Norfolk Southern Railway. Since shipping lines are reducing costs by using larger ships that call at fewer ports, the larger U.S. ports are increasingly successful because of their volume of two-way cargo and their proximity to major markets.

Intermodal transport is expected to become increasingly important in the years ahead. It promises to increase the efficiency of carriers and provide more flexible service to shippers.

## NOTES

- 1 Given pressing overcapacity problems, it is counterproductive to allow economic regulations to delay efficient matching of supply to demand. Although it is possible for airlines to request the Agency to grant exemptions from some of these restrictions, submissions made to us and our research have identified cases where protracted Agency scrutiny of exemption requests has delayed the launch of advertised services. Market opportunities may dissipate if they are not seized quickly.

Where one airline wishes to use blocked space seating capacity on other airlines' aircraft to service its international routes, the Agency takes the position that both airlines must have operating authority under bilateral air service agreements. Many countries recognize the commercial reality of block space agreements by negotiating access to blocked space as well as routes in BASAs. If Canada and the other state party to a BASA recognize their reality and the carriers carry sufficient liability insurance, the *NTA, 1987* section 86 Ministerial direction to the Agency to implement the BASA should instruct the Agency to facilitate authorized block space agreements.

For purposes including ticketing arrangements, each carrier has a designated code. Code sharing is the agreed use by one carrier of other carriers' codes. This allows a carrier the marketing advantage and flexibility to sell transportation in its own name in the other carrier's aircraft for the first carrier's scheduled services. Presently, section 18 of the Air Transportation Regulations requires a carrier to explicitly disclose in its tariffs, advertising, flight schedule displays and tickets whether or not other airlines or aircraft types will be used for its services. A balance must be struck between giving consumers enough information to make market choices and allowing carriers commercial flexibility. Although exemption procedures potentially allow the Agency to determine this balance,

their actual usefulness to carriers and travellers diminishes with delay in determining exemption applications.

- 2 Since 1986 the Uruguay Round of GATT negotiations has been attempting to address the objectives of a new framework for trade in services. In December 1991, the GATT Secretary General submitted a "Final Act" with draft accords. Included in this document was a draft General Agreement on Trade in Services (GATS), with a sectoral annex on air transport services. The annex deals with economic rights such as routes, capacity and pricing. It also includes some of the commercial rights such as aircraft repair and maintenance, the selling or marketing of air transport services, and computer reservation services to which the GATT trade principles would be applied. Progress has been stalled by disagreement over which services ought to be included.

Until all parties can agree, the interim period can expect to see a mixed regulatory system with potentially overlapping and possibly conflicting multilateral, "plurilateral" and bilateral arrangements for the exchange of traffic rights.

- 3 A full investigation was carried out in the U.S. of the impact of conferences on liner shipping; however, it came to no conclusions. In its report to the President and Congress on April 10, 1992, the Advisory Commission on Conferences in Ocean Shipping on April 10, 1992 stated that,

*After a considerable amount of discussion, debate and deliberation, the Commissioners recognized that no meaningful consensus on the major issues would be reached. Therefore, the Report does not include conclusions or recommendations.* (p. xiii)



# 6

## Transportation Policy and the Role of Government

### GOVERNMENT GOALS AND TRANSPORTATION POLICY

Historically, government has used transportation regulation as a policy tool to build our nation. In the years following Confederation, the railway was a lifeline for regions and industries dotting a sparsely populated land. Government played a major role in stimulating the growth of railway companies in order to further its policy goals of economic development and political integration. In the early years, this level of involvement was unavoidable; the youthful transportation industry simply lacked the resources to knit together one of the largest nations in the world.

By the middle of this century, however, it became apparent that other modes of transportation were breaking the dominance of rail. New technologies increased the attractiveness of air, surface and marine transport. But governments were slow to realize that competition could be used to build the transportation system, and continued to rely instead upon regulation. Government interventionism welcomed each new mode of travel with more rules and higher costs. The pattern would continue well beyond the advent of the air industry.

By the late 1960s, the inefficiencies of the regulatory approach were apparent. The *National Transportation Act* of 1967 (NTA, 1967) was Parliament's response, an early attempt to allow emerging market forces, especially between the modes, to play their part in Canadian transportation. Stemming from the recommendations of the MacPherson Commission, the *NTA, 1967*

ended government involvement in rate-setting, established a rail-line abandonment process, and partially compensated railways for passenger rail and branch lines operated in the public interest. This Act tried to foster competition between the railways and other modes of travel. Still, it did not promote competition between the railways themselves, for it allowed them to set the same rates. Nonetheless, the importance of the *NTA, 1967* was that it eased the dependence on regulation in favour of increased reliance on competition.

Twenty years later, the *National Transportation Act, 1987* marked a greater shift toward market forces, and away from regulation as the prime influence on transportation. No longer would competition be restricted by legislation to inter-modal competition only, or competition between modes. The *NTA, 1987* attempted to create new market energies and thereby encourage the best possible levels of service and price for shippers and travellers, by fostering competition between carriers within a mode.

Despite the reforms of 1987, the transportation system is still burdened by entry barriers, subsidies and government ownership of Crown corporations. In addition, multiple — sometimes contradictory — government goals further confuse policy purposes. Various levels of government have used transportation policies to influence their goals in employment, regional development and other fields. The result has been a profusion of “priorities,” few of which bear on the fundamental aim of a healthy transportation system that moves people and goods safely and efficiently.

The inefficiencies imposed by the blurring of policy goals are increasingly difficult to justify in an era of global competition. In fact, the closed economies which previously allowed, or encouraged, multiple policy goals for their transportation sectors no longer exist.

As we noted in Chapter 1, the pre-eminent controlling factor concerning the role of governments in Canada must surely be the inexorable pressure of federal and provincial debt levels, which severely limit their capacity to stimulate, develop and otherwise intervene.

We therefore believe that the *National Transportation Act* should be modified in order to further encourage competition in transportation and

to lessen the role of government. Where government is needed, it should be as a facilitator of transportation and a guarantor of such policy objectives as safety and accessibility. Reforms to the *NTA, 1987* should ensure that, where regulations are imposed on carriers to further policy objectives not central to transportation, those regulations are removed.

In summary, Canadian governments should ensure that efficient, effective and safe transportation constitutes the first goal of our transportation policy. To do otherwise, as we were reminded in our hearings, is to risk "compromising Canada's future competitiveness and prosperity."<sup>1</sup>

### REGIONAL DEVELOPMENT

We have noted that transportation was traditionally viewed as an instrument of national development and integration, even before Confederation. The development of the regions through government initiatives was viewed as a key factor to increasing the prosperity and stature of our nation as a whole. The transcontinental railway provided a link from coast to coast and allowed regions to develop by trading throughout Canada and beyond. Following the world wars, regional development was fostered by massive national investments in transportation infrastructure. The St. Lawrence Seaway was constructed, and huge new investments were made in railways, airports and highways.

This tradition of melding transportation policy and regional development was codified in the *National Transportation Act, 1987*, which stated:

*transportation is recognized as a key to regional economic development and [the] commercial viability of transportation links is balanced with regional economic objectives in order that the potential economic strengths of each region may be realized.<sup>2</sup>*

Regional development, while not specifically defined in the Act, has two essential objectives: first, to ensure that isolated areas have access to modern

transportation and, second, to ensure that regions realize their economic potential within the federation.

These objectives are the preoccupation of governments, not of shippers and carriers. We note that, while shippers and carriers concern themselves exclusively with the need for a competitive and efficient system, the governments of the Northwest Territories, Manitoba, New Brunswick, Nova Scotia and Quebec, as well as the Atlantic Canada Opportunities Agency, continue to see transportation as a policy tool to encourage regional development.<sup>3</sup>

Atlantic Provinces  
Transportation Commission

*"The overall affect of the relaxation of regulatory controls on the transportation industry in Canada has been positive for Atlantic Region shippers."*

emphasis on the transportation and regional development linkage.<sup>6</sup>

The value of continuing to include regional development within the transportation policy is doubtful. While transportation is relevant to employment, defence and other national priorities, few would expect these policy areas to be formally linked to transportation policy. By extension, we contend that governments can meet regional development objectives through more direct means than transportation.

As the rest of the world moves toward greater reliance on market forces to allocate resources, Canadians cannot run their transportation system in isolation. Government programs which defy market forces by subsi-

dizing some transportation services, and restricting the rationalization of others, perversely prevent the development of economically sound — and therefore sustainable — modes of transportation. In the end, such policies produce — and have produced — costly inefficiencies that result in reduced standards of living as we spread cost-inefficiencies throughout the Canadian economy, pricing our goods out of the global market. The resulting economic and social hardship works to the disadvantage of all Canadians, including those living in regions originally intended to benefit from such programs.

We recognize that transportation decisions will continue to have a role in economic development, and that government will continue to be involved. However, efforts should be made to unclutter the transportation system and separate the disparate roles of government. Government projects should be undertaken only when justifiable on a sound economic basis and should be scrutinized with rigour. Where government funds transportation infrastructure for goals other than transportation itself, an appropriate charge should be made to the government portfolio responsible for the accrued social benefit.



#### RECOMMENDATION NO. 33

We recommend that section 3 of the *NTA, 1987* exclude reference to regional development as an element of transportation policy. Regional development policy should be expressed in statutes concerning that subject.

Beyond this, care must be taken to avoid the dismantling of essential transportation facilities. This can and should be done without undermining the principles of the *National Transportation Act, 1987*.

## SUBSIDIES

Ontario Motor Coach  
Association

*"The different modes have not been treated similarly with respect to government subsidies."*

Despite regulatory reforms designed to allow market forces to flourish in transportation, the government still possesses many ways to influence the transportation marketplace, a major one being subsidies.

We have identified three types of subsidies: direct subsidies to carriers; indirect subsidies in the provision of transportation-related infrastructure and services, which are not cost-recovered; and subsidies made through carriers to other beneficiaries.

The following subsidies were among those brought to our attention during the course of our research and consultations. The figures represent fiscal year 1990-1991.

The Motor Vehicle  
Manufacturers' Association

*The transportation system, and the country, can no longer hide behind regulatory or subsidy walls in order to maintain viability. We must meet the competition head on. Doing so has caused, and will continue to cause, some pain as the transportation sector restructures. However, this is not different from what many other sectors are encountering in their efforts to increase productivity, customer service, and product quality.*

Subsidy	Expenditure	Program
VIA Rail	\$442 million	Subsidy for the transport of rail passengers.
Marine Atlantic	\$144 million	Subsidy for the provision of ferry service.
Ferry Service	\$13 million	Subsidy for the provision of ferry services by private operators.
Canadian Cost Guard	\$622 million	Non cost-recovered services provided by the Canadian Coast Guard.
Air Transport Services	\$262 million	Non cost-recovered services to aviation sector.
<i>Western Grain Transportation Act</i>	\$645 million	Subsidizes railway shipments of western grain.
<i>Feed Freight Assistance Act</i>	\$17 million	Subsidizes the domestic transport of feed grains.
<i>Atlantic Region Freight Assistance Act</i>	\$73 million (truck) \$13 million (rail)	Subsidizes freight shipments within the region and between Atlantic Canada and Central Canada.
<i>Maritime Freight Rates Act</i>	\$11 million	Subsidizes freight, generally rail, within the region and between Atlantic Canada and Central Canada.

Throughout our consultations, we often heard very different and often conflicting views expressed on specific subsidy programs. For example:

- The intercity bus industry firmly believes that the government's subsidizing of VIA Rail gives VIA Rail an unfair advantage. They argue that intercity buses could provide a more efficient service if their industry were not so unfairly positioned.
- The trucking industry sees railways as being subsidized to the disadvantage of truckers. Railway carriers and related stakeholders, such as the Canadian Association of Railway Suppliers, argue that motor carriers are subsidized because they do not have to pay for the use of highways.
- Several groups described the *Western Grain Transportation Act* as unfair, claiming that it subsidizes rail service in the west and diverts the movement of grain and other goods to western ports, away from the Great Lakes-Seaway and eastern ports.
- Some parties argued that the Atlantic area freight rates assistance program constituted unfair support for surface carriers and regional industries. Atlantic representatives strongly disagreed, though sometimes suggesting that greater efficiencies were possible.
- Several provinces and municipal governments, as well as organizations representing regional interests supported subsidy programs, arguing that they provide financially accessible transportation to remote and outlying regions.
- Groups representing persons with disabilities, as well as a few carriers, suggested that the provision of accessible transportation needs to be subsidized by federal government.
- Some groups expressed the view that subsidies should be used to achieve environmental objectives.

Subsidies change the behaviour and structure of markets. They act as artificial stimulants which undermine entrepreneurship and cost-efficiency by promoting otherwise inefficient decisions or activity. In short, subsidies can be detrimental to the long-term needs of shippers, carriers and the economy. And it is evident that government's capacity to maintain these expenditures is threatened by mounting debt-loads.

Subsidies must have clear goals and predictable effects. Before any subsidy is granted, three questions should be asked. One, what are the actual direct or indirect effects of a subsidy in terms of costs, benefits and effects on other modes? Two, are there better, more cost-effective ways of meeting the stated objective of a particular subsidy program? Three, how can subsidies be delivered or be amended to minimize the distortions they cause?

Further, subsidies intended for a particular industry or group should be paid directly to that group, and not indirectly through the transportation sector. Subsidizing another sector through transportation only distorts the transportation market. If a subsidy is not directly used for transportation purposes, then it should not be paid from the transport envelope. The Commission believes in the principle that the transportation system of Canada should handle all commodities on the same basis.

The Commission notes that many of the national subsidies, transportation subsidies included, may be in violation of current and emerging international trade agreements. At the time of writing this report, the Uruguay Round GATT negotiations had targeted and called for a change in all trade-distorting national subsidies. It is difficult to imagine that several of the existing transportation subsidies will not be subjected to

Atlantic Canada Opportunities  
Agency

*"There is no doubt that together MFRA and ARFAA have contributed to regional development in Atlantic Canada in terms of investment, employment and income. However, the trade and transportation environment today is very different than when these two Acts were introduced..."*

intensive scrutiny and possible change under the current multilateral trade negotiations.

We maintain that subsidies have a role in the Canadian transportation system. However, subsidies, if not properly employed, interfere with the intention of the *National Transportation Act, 1987*, and prevent the needed rationalization of the Canadian transportation system. Ineffective subsidies are philosophically at odds with the objective of the *NTA, 1987*, which is to induce efficiency, through competitiveness, into the market.



#### **RECOMMENDATION NO. 34**

**We recommend that the Government of Canada assess all transportation subsidies with a view to eliminating or restructuring those which cannot be justified or those which work inefficiently in their present form.**

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#### **RECOMMENDATION NO. 35**

**We recommend that subsidies whose objective is to support sectors other than the carrier industry should be paid directly to such sectors and not through budgetary allocations to transport, or through obligations imposed on carriers.**

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### **INFRASTRUCTURE**

Over the years, Canada has accumulated a superabundance of transportation infrastructure. In the course of our inquiries, we began to recognize that public policy in this area requires fresh attention if we are to maximize our

competitiveness as a nation. We see two challenges for government, both formidable: to rationalize a very large inventory of superfluous infrastructure; and, at the same time, to stimulate further investment of private capital in priority infrastructure having specific public benefit and competitive advantage for the country.

### Cutting Excess

The amount of needless infrastructure is staggering. Thousands of kilometres of excess trackage is being maintained. The government has funded port facilities and wharfage at hundreds of locations. The air navigational system requires rationalization, since technology permits large efficiency gains and reduces the need for flight service stations and towers in low-volume locations. Vessel traffic services are maintained in waterways where compulsory pilotage is required. Even in this age of automation, manned lighthouses beam out from our coasts.

In such a massive system, a compelling need exists for economy and utility if Canada is to avoid a major drain on financial resources. We have been struck by how much productive energy, capability and resources are used in questionable activities at a time when resources are desperately needed for other worthwhile endeavours. The competitive edge that comes from having a world-class transportation infrastructure and low-cost carriers can be decisive for the real generators of a nation's wealth — its manufacturers, entrepreneurs and natural resource extractors.

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Motor Vehicle Manufacturers'  
Association

*"Canada must find a way of knitting its infrastructure together in a more effective means from province to province, as well as across modes, and a better means of enforcing the law to ensure that all parts of the transportation infrastructure will remain free from the types of disruptions that occurred on our roadways at border points over the past two summers."*

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Public spending on infrastructure has long been a favoured way for governments to garner short-term benefits, including job creation and regional economic stimulation. Unfortunately, the existence of such facilities, once built, creates a political imperative which can often depart from economic disciplines. On occasion, governments find themselves attempting to manipulate the market to bring demand to underutilized infrastructure, a situation which no country can afford.

One major reason that political leaders are vulnerable to pressure is the lack of balance between the forces demanding construction or maintenance of facilities and those who will pay for it. Taxpayers do not see the direct costs, nor can they easily judge if an investment is excessive. User groups are more knowledgeable, but since costs are absorbed by the taxpayers, they are usually not motivated to offer protest.

In order to balance the political pressures, a continuous presence of users in the capital spending system is desirable. When those users are paying a real cost associated with greater cost-recovery levels, they will have a vested interest in ensuring the proper level of investment is achieved. Industry consultations in this manner are rare, but have been attempted in connection with the rationalization of the Air Navigation System and with the provision of lighthouse staff on the east coast. Collaborative efforts to examine the value of existing infrastructure will be essential in the future. Without such efforts, we will be unable to direct our scarce resources toward the facilities where the most benefit can be achieved. Proposed cost recovery increases, when implemented, will introduce greater levels of "user pay" to the system. The next step should be to enhance the role of "user say." We note that the concept of "user pay" has been one of the objectives of the *National Transportation Act* since 1967.

### **Stimulating Development**

Even while we recommend an effort to reduce current excess infrastructure, we recognize that Canada, like other nations, competes in the world market wherein modern, efficient facilities can be a critical advantage.

Without any expectation of greater resources, transportation planners face a large inventory of projects which would, in decades past, have been undertaken by the federal government. Transport Canada's Capital Investment Plan (CIP) envisages annual capital requirements, on a discounted basis, of about \$800 million until 1998-99 inclusive. This figure does not include major projects such as new runways and redevelopment of Terminals 1 and 2 at Lester B. Pearson International Airport (Toronto); the development of a container port at Roberts Bank outside Vancouver; and a new runway and expanded passenger terminal at Vancouver International Airport.

Actual expenditure is expected to be limited to \$500 million annually, producing a short fall of \$300 million. The major railways and Ports Canada also plan reduced capital spending through the coming decade, suggesting the probable growth of a capital expenditure "deficit" with implications for future competitiveness.

Although other nations face the same financial constraints, many have introduced intriguing innovations to finance projects which could not be undertaken with tax revenues.

A number of transportation mega-projects are under way around the world. Among them: the super-highway being built to link Hong Kong and Beijing, the Chunnel that will tie the U.K. to the Continent, Osaka's offshore airport and Mexico's new highway system. All involve some mechanism to securitize future revenues — be those revenues in the form of tolls, or other charges — and thereby put capital into the hands of builders in the short term, without drawing excessively on government funds.

Canada, too, has begun using private investors to achieve public ends. The Terminal 3 project at Toronto's Pearson International Airport is the best known of such projects, and will be followed by a second similar project to renovate Terminals 1 and 2. Runway financing at Vancouver International Airport has also been sought from private sources.

These efforts are attractive, but they are not simple. Major differences exist between the decision-making processes of government and those

of capital markets. Individuals accustomed to both worlds are rare, and assumptions differ markedly. Governments must maintain flexibility and keep their options open; private investment requires security and avoids uncertainty.

As the *Financial Times* of London has noted: "The risks and costs... can be immense. Lead times for transport infrastructure projects typically span a decade or more because of the interminable, and usually controversial, planning processes. Companies are reluctant to risk millions of pounds working up projects only to see them collapse or rendered unviable during the planning phase. The risks would matter less if companies could be sure of earning appropriate returns."<sup>7</sup>

These systemic problems require a strategic approach to their resolution. They require a strategic approach based on a comprehensive assessment of the factors involved in fostering transportation infrastructure investment.

The European Conference of Ministers of Transport made similar observations in their "Round Table 91" on private and public investment in transport. They point out that transportation infrastructure projects typically have very long lives (20-100 years or more); experience relatively low operating costs; require large amounts of capital; and have a long construction period (2-7 years). Therefore, financing requires a long-term perspective. In addition, cash flow is negative during construction, which lasts longer than for conventional industrial projects; cash flow grows slowly during the early years of operation, because of the heavy interest rate payments on loans, but it is or can be high after amortization; loan maturities are generally shorter than the in-service life of transportation projects. Political and macro economic risk affect both construction and post-commissioning periods.<sup>8</sup>

We believe that capital investment in public transportation facilities can continue at the necessary rate, but there must be improved co-ordination of the relationship between government and the private sector. The Toronto Terminal 3 program suffered from the mutual inexperience between government and private investors in completing such an ambitious project. Terminal

3 was an innovation. However, evidence that government has not adjusted to the needs of investors is still present in the continuing stalemate over the financing of a new runway in Vancouver, the laborious process underway to initiate improvements to terminals and runways in Toronto and the expense and uncertainty surrounding the proposed fixed link to Prince Edward Island.

When the federal government began a privatization program in the mid-1980s, similar problems existed, and these were minimized by a central federal organization concerned with developing expertise and experience in privatization. Whether or not such a model has utility in this area is a matter for administrative consideration. But even without a central co-ordinating body, the government must ensure that the key departments — Justice, Public Works, Transport, Finance and Treasury Board — have appropriately trained and experienced staff, that different projects receive similar treatment, and that approval processes are clear and delineated at the beginning of the project.



#### **RECOMMENDATION NO. 36**

##### *Cutting Excess*

We recommend, consistent with the "User pay-User say" concept, that the Minister of Transport establish permanent consultative bodies formally involving users of transport services to ensure that complete information is obtained for rational cost benefit analysis of infrastructure investment.

## RECOMMENDATION NO. 37

*Stimulating Development*

We recommend that the federal government develop mechanisms that will attract private capital participation in transport infrastructure financing by offering flexible infrastructure investment opportunities, with appropriate public accountability.

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Canadian Chamber of  
Commerce

*"The most efficient transportation system is not going to be achieved if transportation costs are needlessly burdened by regulation, or rendered uncompetitive by taxes. Federal, provincial, and territorial taxes must all be taken into account."*

of tax drawn from a specific mode and the level of government investment in that same mode.

Pertinent to this matter is section 3(1)(e) of the *NTA, 1987*. It states that

## TAXES

The issue of taxation was not included in our mandate. Taxation was, however, raised repeatedly in submissions made to us. Indeed, it is almost impossible to discuss the issue of transportation competition and efficiency without examining the effects of tax policy.

During our consultations we often heard criticism of the existing taxation framework for transportation. The vehemence with which carriers and other groups condemned the tax system stems, in part, from the fact that no discernible relationship exists between the amounts

*Each carrier or mode of transportation, so far as practicable, [should bear]... a fair proportion of the real costs of the resources, facilities and services provided to that carrier or mode of transportation at public expense.*

The notion of cost recovery is thus preserved in the Act. However, the government has not fully acted upon it. As we noted in the previous section, expanded use of cost recovery would enhance the overall efficiency of the transportation system and ensure fairer competition between modes.

We are concerned that the current transportation services taxation framework works against both the transportation industry and the economy as a whole. This is evident from the taxation issues raised in our consultations.

Many groups raised questions about the purpose of specific transportation taxes. The current taxation system allows governments to use carriers as sources of revenue to be used for the benefit of the whole economy. In the United States, this problem is not as pronounced as in Canada, since U.S. federal taxes on the transportation industry are used substantially on a dedicated basis to finance transportation infrastructure.

The frustration evident during our consultations indicates that transportation taxation is indeed a jungle. By raising revenues wherever possible, and not spending them subsequently on transportation infrastructure, many governments have altered the state of competition and efficiency in the transportation sector, between modes and within modes.

For these reasons, we urge that the tax structure be reformed and brought into line with the principles of the *NTA, 1987*, as noted above. If governments are asking transportation managers and workers to embrace a new, more competitive world, governments must embrace the same marketplace medicine and offer a similarly competitive tax environment. We recognize the magnitude of this challenge. But we feel that steps must be taken to restore the competitive balance and equitably distribute the benefits of efficient transportation.

Our view is that the most valid taxation on transportation is one which amounts to user fees to replenish and restore the system. The transportation specific tax system should be simplified and made more direct, and revenues drawn directly from transport services should "complete the loop" by being reinvested into the transportation infrastructure.

This overall tax reform is not something we expect to happen quickly. Nonetheless, we believe that several of the positions on taxation which were represented to us in submissions and consultations deserve mention and explanation. We would not attempt to judge the validity of these arguments, but we would hope that their presentation here will be of some use to policy makers.

Domestically, the railways maintain that they are at a tax disadvantage vis-à-vis trucking. Their argument has validity in that taxes collected from them are partially used for transportation purposes which may be at odds with their competitive interests. To this end, the railways have asked that the federal government persuade provinces to equalize fuel taxes at a level not exceeding one cent per litre, and to phase them out within two years. They ask also for the elimination of sales tax on rolling stock and of property tax on track-related facilities, and for the assessing of other rail property as for any other business. The railways requested permanent reduction in the federal excise tax on locomotive fuel to one cent per litre. They also believe that the Capital Cost Allowance for railway infrastructure should be replaced by an Investment Tax Credit set at a level sufficient to offset outstanding infrastructure or fiscal inequities between Canadian and U.S. rail carriers and between surface modes in Canada.

We agree that efforts should be made to reform the manner of rail taxation in order to ensure fair competition between the modes.

Shippers, carriers, ports, and many organizations and individuals see taxes as compromising the ability of Canadian carriers to compete effectively against their American counterparts. Comparatively speaking, taxes in Canada versus those in the United States are viewed by many as adding to the overall

cost-inefficiency of Canadian carriers, rendering them uncompetitive in the emerging continental trade order.

Fuel taxes were singled out by all modes of transportation as the largest taxation impediment to successful Canadian competition with U.S. carriers. It was also pointed out that provincial fuel tax rates vary greatly, and that this problem is compounded by competition from U.S. border states.

Canadian air carriers claimed that Canadian fuel taxes put them at a cost disadvantage with their U.S. competitors. The trucking industry expressed similar views.

Similarly, the disparity in property taxes between Canada and the U.S. constituted a major issue, largely for rail carriers. In 1990, Canadian rail carriers said that they paid significantly more in property taxes than they would have had they been subject to U.S. rates.<sup>9</sup> A similar disparity in rates is found between provinces.

Further complaints from all modes, except marine, related to the more favourable U.S. depreciation rates and higher U.S. tax investment incentives. For example, U.S. railroad property is depreciated 100% after eight years, whereas in Canada only 55% is recovered in that time, through capital cost allowances. Similar disparities exist between the air and trucking sectors of both nations. Canadian trucking fleets tend to be older than those of U.S. motor carriers and it has been suggested that this could be due to less generous capital cost recovery rates in Canada. In similar vein, Canadian air carriers also commented on the lack of tax-based leasing available to assist Canadian carriers to finance aircraft acquisitions.

The air industry protested the widespread existence of such "post-ticket" taxes as provincial services tax (PST), the Air Transportation Tax (ATT), the federal Goods and Services Tax (GST) and the Passenger Facilities charge. Such taxes, being "pyramided" on top of one another, were perceived as significant disincentives to air travel, particularly in price-sensitive leisure markets. Canadian Airlines International estimated that these taxes constituted 20% of an average system fare. The government "take" of a fare is significantly lower in the U.S. — 10% of an average system fare. As a

consequence, doing business in Canada was said to be 15 to 20% more costly for Canadian carriers.

However, specific taxation levels on certain cost-inputs (for example, property, fuel and income taxes) are higher in Canada; these levels do not reflect the overall taxation balance between both nations. For example, an examination of the rail sector shows that Canadian fuel, sales and property taxes place a significantly higher burden on Canadian railways than they would bear if U.S. fuel, sales and property taxes were assessed on the same companies. The relative burden changes little if Canadian payroll taxes for Canada Pension Plan/Quebec Pension Plan and U.S. payroll taxes equivalent to U.S. Social Security are added to the equation. Considering only the above taxes, the additional burden on CN and CP Rail has been estimated at \$225 million in 1990 alone. In addition, there is the substantial effect of less generous capital cost recovery rates.

In another area, the inclusion of U.S. retirement taxes in the comparison affects these results. Canadian railways would have paid more in pension taxes under the U.S. regime than under the Canadian one. Considering all taxes and pension costs, we estimate that CN and CP Rail combined would have paid some \$180 million more under the Canadian regime than under the U.S. one.

In the trucking sector, our evidence indicates the burden of federal and provincial/state taxation was higher in Canada, but only by 0.25%, in terms of trucking operating revenue. It should be recognized that this trucking tax burden is not uniform. It ranges from a 0.46% tax advantage for Canadian LTL (less than truck load) carriers to a 0.80% advantage for small U.S. TL (truck load) carriers.

The evidence suggests that Canadian rail carriers are at least marginally more burdened by taxes than their U.S. counterparts. Still, it should be recognized that there are advantages and disadvantages for rail in each country — indeed, in each province. This being the case, the long-term success of our carriers will depend more on improved overall efficiency and initiative

than on possible advantages to be gained through a radically changed taxation regime.



#### **RECOMMENDATION NO. 38**

**We recommend that all levels of government adopt policies to ensure that taxation structures and rates do not affect adversely either the ability of Canadian carriers to compete in interprovincial and international markets or access by Canadian travellers and shippers to such markets.**

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#### **CANADIAN PORTS SYSTEM**

Seaports in Canada are currently facing rapid and dynamic changes in their operating environments. Fundamental changes in international trade patterns, vessel size and shipping company operating strategies threaten the continued commercial viability of some ports, especially in eastern Canada. The structure of the Canadian ports administration system itself is not conducive to a flexible response to rapidly changing global trade patterns.

The overall responsibility for ports lies with the federal government, as set out in the *Constitution Act*. There are currently three tiers in Canadian port administration: Canada Ports Corporation (CPC), harbour commissions, and public harbours and ports under Transport Canada. The CPC controls 15 ports, of which seven are local port corporations (LPC), the largest being Halifax, Montreal and Vancouver. Their boards of directors are appointed by the government and have a significant degree of autonomy. However, they rely on the federal government for all their capital funding,

since they cannot raise capital independently or accumulate reserves, in contrast with the freedoms afforded U.S. ports.

There are nine harbour commissions, in Ontario and British Columbia, whose directors report to the Minister of Transport. The commissions have always acted autonomously, servicing the requirements of their local economies. They have the right to accumulate reserves, although they must have federal approval for major capital spending projects.

The public ports and harbours, currently numbering 526, are generally very small and either serve local interests or are necessary for community survival, especially in remote regions.

The controversy surrounding Canadian ports administration is based on the inability of the large seaports to respond adequately to external events and economic forces affecting their survival. Canadian ports currently face intense competition from U.S. ports, who have invested heavily in terminal and port equipment, service larger hinterlands, benefit from greater economies of scale, and can react independently to service requirements.

Canadian ports, especially in the container trades, have to compete against U.S. ports, which are able to accommodate the jumbo vessels servicing the major international trade routes. Vancouver and Halifax are especially exposed to this form of competition, having the physical capacity to accommodate the vessels, yet being increasingly unable to induce the carriers to use the port due to inland transportation costs, costs enforced by CPC and ancillary charges such as pilots. As international trade is "port blind," ports and the transport systems servicing them must be able to compete on price and service levels to attract enough traffic for their survival.

Port administrations can be organized on either a centralized or regional basis. The former allows for a comprehensive strategy for port investment and mitigates the problem of ports competing against each other for funds. The latter allows ports to react quickly and effectively to changes in the international environment and to respond to demands from the industries they serve.

Canada has a history of financial troubles arising from centralized ports administrations, especially in terms of debt loads on the federal government. The choice between centralized as opposed to regional control of ports rests on judgment: whether the benefits achieved through consolidation, reduced overheads and a centralized investment policy, which considers national as well as regional concerns, outweigh the benefits of flexible operations and investment decisions.

The current situation of overlapping jurisdictions, costly centralized administration and lack of investment flexibility at the individual port level has a negative impact on the economic viability of ports, as well as the industries they serve. The solution to this problem would require a major overhaul of the Canadian ports administration system.

### CN RAIL

Government is directly involved in transportation through its operation of a number of agencies and through direct ownership of operators in various modes. In the case of rail, the government actually has the dominant market position through its ownership of CN.

As we have noted, Canadian transportation markets and competition matured in the second half of this century, offering the potential for competitive alternatives to rail. This fact — and similar advances in other modes — was recognized and promoted in the *National Transportation Act* of 1967 and 1987.

There is a cost for maintaining a massive government presence in rail through a Crown corporation. CN's periodic recapitalization (the last major one being in 1978) is a substantial taxpayer cost. In addition, the competitive goals of the *NTA, 1987* have been limited because the government, as an owner, is not subject to the same bottom-line discipline as owners in the private sector.

The government's ownership of CN is no longer justifiable. The company is no longer performing a public policy mandate. It is also increasingly active in the United States, which suggests that the corporation's mission is

evolving to become more continental. We believe that the privatization of CN would remove a large obstacle to implementing a genuinely competitive environment in the rail mode. We further believe that the privatization would help enhance service and lower rates for shippers.

There is precedent for divesting major Crown corporations. Canadair, Teleglobe, Air Canada and PetroCanada are no longer Crown corporations. In fact, there has been an ongoing divestiture of CN non-rail assets since the Corporation's 1978 recapitalization. CN divested itself of CN Hotels, three telecommunications companies and its trucking business and is looking to sell CN Exploration.

Total divestment of such a large entity may not be easily accomplished. It is doubtful that a single buyer could be found, and imaginative strategies may have to be sought. There are numerous possibilities, including the sale of parts of the system. There might also be innovations such as the co-operative use of trackage by more than one railway. Divestment strategies should be examined in order to find the most beneficial to the taxpayers.



#### **RECOMMENDATION NO. 39**

**We recommend that the Government of Canada  
initiate measures necessary to privatize  
Canadian National Railways.**

#### **GOVERNMENT JURISDICTION AND CO-OPERATION**

Perhaps the most common argument we heard throughout our consultations was a demand for better co-ordination of government policies such as trucking regulations, provincial railways, taxation and infrastructure. We also

heard a call for greater co-ordination between federal and provincial administrations — and between various parts of the federal government itself.

We cannot overemphasize the need for regulatory harmonization. One of the main lessons from our review is that the current balkanizing of Canada through conflicting or incompatible regulation has had a major and foreseeable effect: rising transportation costs throughout the system.

The Canadian Chamber of Commerce, for example, told us:

*If Canada does not review and address... issues quickly in an integrated, multi-jurisdictional way, transportation decisions and choices for shippers will continue to favour U.S. based carriers and ports.*

---

Canadian Pulp and Paper  
Association

*"The Federal government must exercise leadership with respect to achieving uniformity of weights and dimensions on the highways of Canada to ensure a consistent, predictable and reliable truck transportation system which meets the requirements of Canadian shippers."*

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There have been examples of efforts toward national collaboration. In 1988, provincial governments agreed to harmonize standards for truck sizes, weights and dimensions, an action designed to facilitate coast-to-coast trucking services. A four-year planning effort by the Transportation Association of Canada (TAC) produced an agreement by federal and provincial governments on a national highways program which spans the entire country and involves spending commitments for several decades. Even critics of such programs admit the policy direction was consistent and inclusive of all parties.

However, it is also true that, despite this 1988 agreement, the hoped-for benefits have not been entirely realized because full harmonization has still not occurred. And the co-operation that led to the National Highways

Program disappeared when the parties began to question the division of the funds.

Although co-operation seems a simple enough concept, there are significant reasons why it remains difficult for elected officials. Regardless of their good will and national vision, political leaders are responsible to their electors, and only their electors. Co-operative efforts succeed when both levels of government have jurisdiction and, therefore, the responsibility that comes with balancing, and budgeting, of priorities. They work less well when one level of government has demands and the other has the financial responsibility.

This is not to say that co-operation is impossible. But cross-jurisdictional planning is far more challenging than it seems, and perhaps depends most of all on the participants' perception of mutual benefit — a condition that cannot be guaranteed in each of the many areas where co-operation is desirable.

We were impressed by the professionalism of the TAC's planning for the National Highways Program. But we are concerned that without a sense of mutual responsibility, similar success will not be forthcoming in the parallel effort to plan the future of Canada's railways.

In 1990 the Provincial Ministers of Transportation established a committee to designate an "essential" rail network, with the intent of protecting this network from abandonment through some subsidy intervention. Unfortunately, as we examined this work, we became concerned with the readiness with which parties describe some rail service as "essential."

In its early work the transportation ministers' committee proposed criteria which were extremely broad. While we acknowledge that non-economic criteria might make a particular rail line exceptionally important, few examples come immediately to mind. Certainly there is no justification for declaring entire networks "essential."

We do not question the sincerity or the skills of the participants, but we have concerns that this exercise could perversely stall the much-needed rationalization of the rail system. A delay of this kind would be not only

unfortunate, but potentially damaging to users and carriers and to the economy as a whole.

Alternatively, the essential rail study, if administered rationally, could encourage all of the governments involved to use parallel efforts — highways and rail planning — to integrate their surface transportation policies. Since the highway plan seems well advanced, the essential rail study offers an excellent opportunity for participants to not only improve federal-provincial planning, but to integrate modal groups within each government as well.

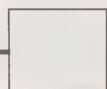
### A NATIONAL POLICY

Does Canada need a 'National Transportation Policy'? The current comprehensive legislative policy statement is section 3 of the *NTA, 1987*. Unfortunately, it is honoured more in the breach than the observance. In the course of our review we have identified concerns which should be reflected in amendments to section 3. As we observe in Chapter 7, concise legislative purpose clauses are useful in providing guidance to courts and the Agency in interpreting the *NTA, 1987*.

We recommend in this Chapter that section 3 of the Act not refer to regional development as an element of transportation policy. Regional development policy should be expressed in statutes concerning that subject. Consequently, section 3(1)(d) should be repealed. Likewise, since we do not consider that any general public interest operating duty should be imposed on commercial carriers, it is inappropriate to retain section 3(1)(f) of the Act.<sup>10</sup>

The present wording of section 3(1)(g) is unnecessarily complex for a legislative purpose clause. Except in those cases where we have determined that regulation of contract terms is necessary or that specialized devices are needed to ensure competition, our basic conclusion is that market forces are the best means of achieving the objectives presently detailed in section 3(1)(g). Given the recent amendment to section 3(1) declaring the importance of access for persons with disabilities, section 3(1)(g) would be more appropriate as part of a purpose clause if it were rewritten to reflect

the general goal that the transport system facilitate interprovincial and international trade.



#### RECOMMENDATION NO. 40

We recommend that section 3 of the *NTA, 1987* be amended to replace section 3(1)(g) with a general policy goal that the Canadian transportation system facilitate interprovincial and international trade.

Since commercial concepts and uses of transportation have moved from the employment of single modes to integrated logistics management, in Chapter 4 we have recommended that section 3 expressly refer to facilitating intermodalism.

To achieve its intended objective as a legislative purpose clause, we believe that section 3 should be revised to express only the most fundamental and consistent elements of Canadian transportation policy. To reflect our report, we suggest section 3(1) be worded:

3. (1) It is hereby declared that a safe, economic, efficient and adequate network of viable and effective transportation services accessible to persons with disabilities and making the best use of all available modes of transportation at the lowest total cost is essential to serve the transportation needs of shippers and travellers, including persons with disabilities, and to maintain the economic well-being and growth of Canada. Those objectives are most likely to be achieved when all carriers are able to compete, both within

and among the various modes of transportation, under conditions ensuring that, having due regard to national policy and to legal and constitutional requirements,

*same*

(a) the national transportation system meets the highest practicable safety standards,

*same*

(b) competition and market forces are, whenever possible, the prime agents in providing viable and effective transportation services,

*replaces former 3(1)(g)*

(c) legislation and economic regulation governing each mode of transportation facilitate the development of interprovincial and international trade,

*former 3(1)(c)*

(d) economic regulation of carriers and modes of transportation occurs only in respect of those services and regions where regulation is necessary to serve the transportation needs of shippers and travellers and such regulation will not unfairly limit the ability of any carrier or mode of transportation to compete freely with any other carrier or mode of transportation,

*same*

(e) each carrier or mode of transportation, as far as practicable, bears a fair proportion of the real costs of the resources, facilities and services provided to that carrier or mode of transportation at public expense,

*new*

**(f) legislation and economic regulation governing each mode of transportation facilitate the development of, access to and use of intermodal services.**

Commercial and technological innovation pose challenges for policy development because transport systems transcend both accustomed ways of thinking and departmental boundaries. The policy development process must involve all stakeholders in the transportation system and must be continuous and proactive.

Of itself, a new federal legislative declaration alone does not answer those who told us that Canada needs a joint policy which would bind governments at federal and provincial levels. More is required than just a consistent declaration of fundamental policy. We see potential in section 3(2) of the *NTA, 1987*, which authorizes the Minister of Transport, with Cabinet approval, to make agreements supportive of national transportation policy. This could enable federal/provincial agreements to be struck, giving substance to the current efforts of the TAC to develop co-ordinated national transportation goals.<sup>11</sup>

By suggesting the use of intergovernmental agreements, we recognize the difficulties inherent in translating the elements of a joint policy into workable legislation. The levels of government have differing responsibilities and therefore different goals. We hope our report will create a greater awareness of the larger national context, thereby helping all participants (be they the federal government, provinces or others) to see close co-operation as an exercise in enlightened self-interest. After all, the best reason for federal/provincial co-operation is that there is only one tax-paying public. The degree to which governments duplicate services, or fail to secure the maximum benefits with available monies, is the degree to which they fail the public. Moreover, without a strong and well integrated domestic economy, it will

be difficult to maintain a strong and coherent presence in the increasingly competitive global economy.

## NOTES

- 1 Canadian National Railways.
- 2 *National Transportation Act, 1987*, s.3(1)(d).
- 3 Submissions to the NTARC.
- 4 ACOA, N.W.T. submissions to the NTARC.
- 5 Ontario, Ministry of Transport. *Economic Corridor Series*, March 1989–May 1991.
- 6 Heads, John (Transport Institute, University of Manitoba). *Transport and Regional Development: The Prairie Provinces*, Transport Canada Economic Research, May 1992.
- 7 Bisson, B.G., et al. *Regional Economic Development and Transportation: Transportation as a Competitive Factor in Atlantic Canada*, Transport Canada Economic Research, May 1992.
- 8 Financial Times, November 4, 1992.
- 9 European Conference of Ministers of Transport. Round Table 81. *Private and Public Investment in Transport*. Paris, 1990, pp.8-10.
- 10 Submissions to the NTARC (CN, CP Rail)
- 11 Under our recommendation no. 8, railways would continue to have an obligation to submit a reserve operating proposal as a condition of a railway line abandonment notice. Also, we recognize that carriers have appropriate duties in emergency situations, such as those provided for in the *Canada Shipping Act* and the *Emergencies Act*.
- 12 The Transportation Association of Canada is a federal-provincial governmental association. Its board has decided recently to develop a unified national strategy to lead to greater integration of all transport modes, address taxation policies which affect carriers and consider issues of government regulation.





# 7

## The Legislation and the Agency

### INTRODUCTION

We have reviewed the economic, political, social and even strategic considerations that shaped the laws and regulations governing our national transportation system. We have learned that transport policy gradually evolved from regulation by necessity, to conflicting regulation, to over-regulation, and ultimately to the *NTA, 1987* which attempted to facilitate the winding-down of regulation. In this chapter, we turn our attention to the legislation and the National Transportation Agency which was created to administer it.

### THE LEGISLATIVE AND REGULATORY FRAMEWORK

#### Structure of the *National Transportation Act, 1987*

The essential philosophical difference between the legislation of 1967 and the *NTA, 1987* is found in the new law's attempt to implement the pro-competitive thrust of *Freedom to Move*. Under the *NTA, 1987*, the old regulatory body and its duties were changed, alternate dispute-resolution procedures were added, and new rules were introduced to govern acquisitions. Major amendments were intended to increase competition between and within modes.

The *NTA, 1987* is an Act in eight parts, with Parts I, VII and VIII applying to all modes. All other parts are mode-specific. Section 2 establishes the extent and limits of application of the legislation while section 3 embodies the principles of *Freedom to Move* as the core of Canada's national transportation policy.

### Fording Coal Limited

*"What we really need is transportation legislation that is cognizant of the changing international marketplace, and that is flexible enough to allow this country to become competitive in that marketplace. Above all, this legislation must enable suppliers of transportation services to manage their business so as to be able to provide low cost services, free of excessive regulations ...*

*Our transportation policy must bring together all components of the transportation industry, rather than dealing with them separately, if it is to have any hope of fostering efficiency."*

The *Motor Vehicle Transport Act, 1987* delegates administrative authority for extraprovincial bus and truck carriers to provincial regulatory bodies. Part IV of the *NTA, 1987* provides for residual jurisdiction over extraprovincial motor vehicle services not covered by the *MVTA*.

Part V applies to northern marine resupply services and combines with other statutes to regulate aspects of the marine industry. The latter

group of statutes includes the *Shipping Conferences Exemption Act* and the *Coasting Trade Act*.

Part VI regulates those pipelines which carry beyond provincial boundaries commodities other than oil, gas or municipal water/sewage.

Part VII establishes procedures for the review of proposed acquisitions of Canadian transportation undertakings, and Part VIII contains general and transitional provisions, including the mandate for annual Agency reviews preceding the National Transportation Act Review Commission.

### **The Purpose Clause**

In its acceptance of the principles of *Freedom to Move* as being at the core of Canada's national transportation policy, section 3 of the *NTA, 1987* serves as a formal parliamentary affirmation of such principles in the statute's purpose clause. While it is not without inappropriate elements (such as inclusion of regional development as an element of transport policy), we believe that section 3, if amended, could have greater utility as a guide both to the Agency in making its decisions and to the courts in interpreting the *NTA, 1987*.

The essential weakness of the current section 3 which has come to light in our deliberations is one not uncommon to such legislated policy statements. If a purpose clause becomes the repository of the wishes of many competing interests, its usefulness diminishes and it can lead to contradictory interpretation. Vague laws and contradictory interpretation result in uncertainty and delay which hampers business planning and investment.

If amended as we have discussed in Chapter 6 and recommend in our report, section 3 would become a clearer and more consistent expression of fundamental aspects of transportation policy.

### **The Constitution**

Since 1867, the Canadian Constitution has affected the working of the transport industry and the ability of governments to regulate because the Constitution divides legislative authority for transport between the federal and

provincial governments. In 1867, a realistic distinction could be drawn between responsibility for interprovincial transport operations, such as main line railways and shipping, which was given to the Government of Canada, and purely local needs, like roads and rail lines within a province, which were given to the provinces.

In succeeding decades, appeal court rulings have acknowledged the need to interpret this division of powers in light of new technology and business methods. For example, the power to legislate air transport was given to the federal government. The courts, however, have cautioned that the constitutional division of power does not allow any one level of government to regulate all aspects of the transportation process solely on efficiency grounds.<sup>1</sup>

Today, the Government of Canada has constitutional power to pass laws concerning:

- carriage by air or by water;
- carriage on land by an interprovincial undertaking;
- carriage on land under a through bill of lading issued by a water carrier; and
- temporary terminal storage during carriage by the above means.

Through commercial means such as freight forwarders, there is an increasing trend toward separation of the marketing of transport services from the ownership and operation of transport equipment. The Supreme Court of Canada has held<sup>2</sup> that a business providing interprovincial or international services can be regulated by the Government of Canada as an interprovincial undertaking even though its plant and equipment are located in one province. This decision would allow the federal government to pass laws encouraging commercially flexible transport services.

The Government of Canada may also use its constitutional trade and commerce power to regulate both transport and trade in goods where:

- the statutory purpose is directed to the economy as a whole;
- provinces jointly or individually cannot effectively regulate a transport system;
- a national regulatory scheme is set up; and
- a regulatory agency is given an oversight role with respect to a transport system.<sup>3</sup>

The authors of the 1867 Constitution did not foresee integrated logistics systems or environmental review. The legal framework for new technology and commercial systems cannot be fitted easily into the existing constitutional division of powers. However, legal methods exist to make such a fit. Courts have recognized the right of the federal or provincial governments to delegate the administration of a statute to each other. This is done, for example, in the *Motor Vehicle Transport Act*, where the administration of extraprovincial trucking is delegated to the provinces' trucking regulatory boards. The Government of Canada and a province may also agree to set up a joint regulatory board having powers granted by both levels of government. Care must be taken that such joint boards are accountable to elected legislators.

It is clear that the Constitution puts real limits on the federal government's ability to translate transport policy into law.

## Operating Legislation

Historically, the Canadian government saw operational and economic regulation as specific to each mode. The *Railway Act*, *Canada Shipping Act* and *Aeronautics Act* were drafted originally as comprehensive codes controlling all aspects of each mode. The policy direction advocated by the 1961 MacPherson Commission, that the transport industry be viewed as a whole for purposes of economic regulation, was reflected in the 1967 NTA's combining of the functions of the Air Transport Board, Board of Railway Commissioners and Minister's licence powers for the coasting trade, under the umbrella of the Canadian Transport Commission (CTC). The process of

consolidating economic regulation away from the modes was accelerated in the 1987 Act.

The modal statutes continue to give powers to the Minister of Transport and specialized agencies such as the Civil Aviation Tribunal and the Board of Steamship Inspectors to regulate operating standards and technical aspects of day-to-day operations.

### Competition Statutes

The *Competition Act* establishes a regulatory regime and system of penalties to encourage advancement of commercial competition generally. Certain activities of liner shipping conferences, which otherwise would be unlawful conspiracies in restraint of trade, are excused from the consequences of the *Competition Act* by the *Shipping Conferences Exemption Act*.

In addition to the general supervision of competition by the Director of Investigation and Research and the Competition Tribunal under the *Competition Act*, the *NTA, 1987* is intended to encourage transport competition by such transport-specific methods as confidential contracts and competitive line rates (CLRs).

We have asked ourselves whether the goal of encouraging an efficient and competitive industry will be achieved best by general competition rules which apply to all industries or rules specific to the transportation sector or even modes within that sector. The various *NTA, 1987* rules were intended to 'kick start' competition, particularly by providing better access to rail transport.

One drawback of implementing detailed rules in a statute is that the lawmaking process tends to lag behind developments in commerce and technology. For example, the *NTA, 1987* still requires signed carriage contracts in an era when EDI is becoming more prevalent.

Many shippers told us that although they do not make frequent use of specific competitive tools such as CLRs or final offer arbitration, the mere existence of such rules encourages fair bargaining of confidential contracts. Once carriers become accustomed to such bargaining, mode specific competitive tools may decline in importance to shippers. In the long term, such

*Competition Act* provisions as control of predatory pricing, abuse of dominant position, review of mergers and the consent order process may become more appropriate for ensuring competition in commercial transportation arrangements not yet foreseen.

We conclude that those advocating specialized procedures to encourage competition in any mode should have the responsibility to demonstrate, first, why the *Competition Act* procedures are insufficient for this purpose and, second, why any proposed transport-specific rule would work better.



#### RECOMMENDATION NO. 41

**We recommend that any statute providing for specialized regulatory devices to encourage competition in transport industries should include provision for independent periodic review of the continued need for such devices after enactment.**

#### Foreign Investment Regulation

Most commercial foreign investment in Canada is regulated by the *Investment Canada Act*. The review process under that statute, however, does not apply to investments in Canadian businesses that provide “any transportation service.” Part VII of the *NTA, 1987* provides for review by the Agency of “transportation undertakings” under Parliament’s authority. Under Part VII, the Agency may hold hearings to decide if a proposed merger or acquisition of a transportation undertaking with assets or sales over \$10 million serves the public interest. This is a hybrid regulatory power directed to both competition within Canada and foreign investment.

With the exception of international scheduled air transport, we do not see the necessity of applying merger or investment rules to the transport sector different from the general review procedures under the *Competition Act* and *Investment Canada Act*. The *NTA, 1987* does not give content to its definition of public interest. If, as we believe, the *NTA, 1987*'s basic purpose is to maximize competition, maximizing competition is exactly why the *Competition Act* was put in place. A Part VII review under the *NTA, 1987*, in addition to a review under the *Competition Act*, adds nothing to the achievement of public policy goals. An additional layer of regulatory review unnecessarily increases expense, delay and business uncertainty. Such overlap was evident in the recent proposed merger of Canadian Airlines International and Air Canada, which was to have been reviewed simultaneously by the Agency and the Bureau of Competition Policy. The repeal of Part VII would eliminate unnecessary duplication with the activities of the Bureau of Competition Policy. The foreign investment review function of Part VII could be assumed by *Investment Canada*.<sup>4</sup>



#### RECOMMENDATION NO. 42

**We recommend that Part VII of the *NTA, 1987* be repealed and that the exemption of transportation services from the *Investment Canada Act* be repealed.**

Aside from Part VII, the only other control on foreign investment in the *NTA, 1987* is found in Part II, which limits to 25% the voting control which non-Canadians may hold in air carriers with domestic service licences. However desirable may be increased access by Canadian air carriers to foreign investment for domestic air services, international air route allocation

and carrier designation are still tied to the concept of the national carrier set out in the 1944 Chicago Convention. The *NTA, 1987* confers responsibility on the Agency to administer international air route agreements, through section 86 ministerial direction or designation as the Canadian aeronautical authority.

The Agency also has responsibility under the *Coasting Trade Act* to administer waivers for the entry of foreign flag ships into the Canadian coasting trade. Various countries retain restrictions on entry of foreign flag vessels into their coasting trades. While international air transport markets are challenging the assumptions of the Chicago Convention, in shipping, rigid United States ownership restrictions have survived international trade negotiations. Because of the international legal environment of air carriage and coastal shipping, there is a continuing need for a regulatory process to administer entry of foreign air and marine carriers. We believe it is appropriate that the Agency continue to exercise its statutory responsibilities in these areas.

### **International Treaties and Trade Agreements**

The Government of Canada has the constitutional power to negotiate and sign international conventions. Although not free from doubt, the constitutional trade and commerce power may permit the federal government to pass legislation implementing international treaties affecting all transport services and undertakings.

Once a treaty is ratified, international commitments may constrain the policy choices available to any level of government passing domestic legislation. The North American Free Trade Agreement (NAFTA), for example, would provide for non-discriminatory treatment of Canadian, U.S. and Mexican applicants for trucking licences. The same entry requirements would be applied to applicants from all three countries if the NAFTA is ratified. Because the NAFTA would permit other countries to 'opt in' to the Agreement without renegotiating its terms, the ability of Canadian transport regulatory laws and practices to favour domestic operators against foreign competition would narrow if the NAFTA is extended to other countries.

Paradoxically, the NAFTA would not eliminate interprovincial transport regulatory barriers, as long as foreign operators were subject to the same restrictions as Canadian operators. Canada's entry into the NAFTA would reinforce the fundamental need to remove technical barriers to transport operations between provinces.

### THE NATIONAL TRANSPORTATION AGENCY

#### Mandate

The Agency was established on January 1, 1988. It was conceived as the overseer of economic regulatory reform in the transportation industries under federal jurisdiction. Given the unique role of regulating the transition to less regulation, the Agency was intended to operate differently in several fundamental respects from its predecessor, the CTC. The prevailing philosophical and policy direction was reflected in the development of an agency that is more an overseer of market forces than a regulator of transport.

The Agency's mandate involves actions intended to reduce administrative impediments, maximize accessibility by the public and encourage a multimodal approach on transportation issues. Its structure abandons the modal committees of the former CTC. Such a structure was believed to be more conducive to intramodal as well as intermodal competition. The shift reflects an intended transition from regulator to investigator; from policy-maker to catalyst for dispute resolution. The harmonization of regulatory oversight across different modes was seen as pivotal to realizing the principles of *Freedom to Move*.

#### Organization

The Agency comprises a maximum of nine permanent members from all regions of Canada, one of whom is Chairman and Chief Executive Officer. All are appointed by Cabinet for five-year renewable terms. The Agency is managed by the Executive Director, who serves as Chief Operating Officer. Staff are organized into the following Branches: Dispute Resolution, Market Entry

and Analysis, Transportation Subsidies, Legal Services, Corporate Management & Human Resources, and Secretariat & Regional Operations.

In 1992-93 the Agency has a budget of \$35 million and 508 authorized full or part-time staff. Among the assigned Agency functions is the production of an annual review of the interrelationships among the Agency, its stakeholders and the Canadian economy. The 1991 *Annual Review* was prepared at an approximate cost of \$2 million. This was the last of the four reviews required by the *NTA, 1987*. The Minister of Transport has directed the Agency to prepare similar reviews for 1992 and 1993. We have found these reviews most useful, and believe that continued annual reviews beyond 1993 would benefit the Agency and its stakeholders. The emphasis of such reviews should shift from preparation for scrutiny of the *NTA, 1987* by this Commission to the broader issue of transport regulatory process efficiency in a changing commercial environment. For example, if our recommendations are implemented, we consider it no longer necessary to continue to monitor specific activities which section 267 requires, such as the number of confidential contracts filed.



#### **RECOMMENDATION NO. 43**

**We recommend that the Agency continue to prepare annual reviews after 1993, with revisions to their scope reflecting current stakeholder concerns.**

#### **Policy**

Prior to the *NTA, 1987*, federal transportation policy was made by the Minister of Transport with diminishing input from the CTC. The CTC's research and co-ordination duties included the conduct of economic analysis to assist the government in transport mode development and in subsidy decisions. The

new legislation removed this function and required the Agency to follow binding Cabinet policy directives. None has been given.

We support the general principle of transportation policy being formulated by line departments whose ministers are responsible to Parliament. We are concerned that insufficient attention has been given to co-ordination of transport policy and that the Agency has lacked the intended external guidance, as mentioned above, on policy matters in a rapidly changing commercial world. We believe that the Agency would be better positioned to function more effectively in its intended statutory role as a responsive administrative tribunal if it were given clear policy direction. To this end, there should be a more proactive effort on the part of the Department of Transport to establish and co-ordinate transport policy. Such co-ordination would facilitate the issuance of policy directions by Cabinet to the Agency as the legislation contemplates.

### **Adjudication**

The Agency is given a broad range of authority to act as an administrative tribunal and render decisions. Throughout the Act, various adjudicative powers appear in relation to potential decisions arising in the various modes.

Under Part II, Air Transport, the Agency may in the public interest place conditions on any licence granted in the North. In fact, the Agency has decided not to restrict entry into northern air services.

Under Part III, Railway Transportation, the Agency must hold hearings in response to complaints and may vary or cancel charges; fix route rates and their apportioning among railways; order that lines be connected; establish alternative means of determining a CLR; and make recommendations for the transfer or exchange of rail lines, granting running rights, connecting branch lines and abandonment of lines.

Under Part IV, Motor Vehicle Transport, the Agency's powers with respect to those matters not delegated to the provinces for administration include the issuance of licences if the appropriate test is satisfied, the amendment or suspension of licences and the disallowance or replacement of any

tariff. At present, only the trans-Newfoundland bus service is regulated under this Part.

Part V, Northern Resupply Services, is intended to regulate marine carriage to isolated communities which depend on water transport. Most of these communities are served primarily by single carriers. The licences to carry on such services may be reviewed, cancelled or suspended. Such carriers must file tariffs with the Agency, which may refuse proposed rate increases. These carriers have chosen contracting methods to exclude mandatory application of the *Carriage of Goods by Water Act*. Their contract terms exclude or limit liability to a greater extent than in international water transport. There is potential here for market distortion by near monopoly.



#### **RECOMMENDATION NO. 44**

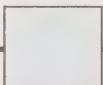
**We recommend that Part V of the NTA, 1987 be amended to permit regulation by the Agency of northern resupply carriers' contract terms.**

In addition, the Agency acts as a tribunal for hearings under other regulatory statutes, such as the *Pilotage Act* and the *Railway Safety Act*.

#### **Public Investigations**

The *NTA, 1987* creates an obligation on the Agency to investigate any complaint, but leaves the conduct of any such investigation, including the holding of a public hearing, up to the Agency. This reflects a policy decision to substitute a public complaints process for regulator initiated investigations. This policy is reflected in the requirement that, upon notice of withdrawal by the complainant of its request for an investigation, the Agency must discontinue its investigation.

The Agency's ability to investigate ceases when the complaint is withdrawn. In one instance, a complainant had withdrawn its complaint just prior to the final argument stage of a public hearing into the issues it raised. Because complaints may arise from general dissatisfaction with the regulatory system or general non-compliance by operators, as well as the impact of individual decisions, we feel in the interest of public confidence in the regulatory process that the complaints process should be retained, with alterations to its procedures.



#### **RECOMMENDATION NO. 45**

**We recommend that the Agency be given the discretion to continue an investigation in the public interest after a complaint is withdrawn and the discretion to require a complainant to pay the costs of the Agency and the investigated party if the Agency is satisfied that the complaint was brought in bad faith or for a private commercial purpose.**

#### **Enforcement**

The *NTA, 1987* permits the Agency to impose terms on orders that it issues and to make interim, conditional and time-limited orders. The Agency is empowered to enforce its own orders, or apply to have its orders made an Order of a court, so that judicial remedies such as contempt proceedings become available. The Supreme Court of Canada has confirmed recently<sup>5</sup> that Parliament validly can give an administrative tribunal enforcement powers.

While the Agency can require evidence to be produced before it in the course of a Part I investigation or an application, the Agency lacks explicit statutory power to gather evidence as to whether, for example, a

person is operating an air service without the required licence. An unlicensed carrier operating without adequate or any insurance can compete unfairly with carriers who comply with the law. Such an unlicensed and underinsured carrier puts passenger or third party victims of accidents at risk of not being compensated.<sup>6</sup> There is therefore an economic interest in enforcing licensing requirements in addition to technical safety standards set by laws governing operation of transport equipment. Because persons operating without a required licence are likely to do so furtively, proper investigatory powers are needed. These statutory powers and the way they are exercised should comply with the Charter of Rights controls on investigations set out by the Supreme Court of Canada in *Hunter v. Southam*<sup>7</sup> and later cases.



#### **RECOMMENDATION NO. 46**

**We recommend that the *NTA, 1987* be amended to give the Agency investigatory powers over persons offering transport services for which a licence and evidence of insurance are required.**

The *NTA, 1987* includes offence provisions in Parts II through VI, covering the various modes of transportation under the Agency's jurisdiction. Generally, failure to comply with the Act or an order made under each Part is a summary conviction offence, with maximum fines of \$5,000 for individuals and \$25,000 for corporations. Because relatively few prosecutions have occurred under the *NTA, 1987*, courts lack a body of case law on which to base sentencing decisions. We do not see any need to make noncompliance with every section of the *NTA, 1987* an offence. Such statutory overreach may offend the Charter. In enforcing economic regulation, a rifle is more appropriate and accurate than a shotgun.



#### RECOMMENDATION NO. 47

We recommend that the section 103 hybrid offence of the *NTA, 1987* be repealed and re-enacted only as a summary offence.

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#### RECOMMENDATION NO. 48

We recommend that the *NTA, 1987* enforcement provisions be amended to restrict regulatory offences to:

- wilfully avoiding provision of statutorily required information to the Agency;
- providing false information or obstructing an Agency investigation;
- operating a service without required approval;
- contravening operating licence terms; and
- failing to comply with an Order of the Agency.

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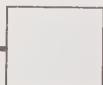
#### RECOMMENDATION NO. 49

We recommend that the *NTA, 1987* be amended to provide for sentencing guidelines such as the number of days the accused was committing the offence and the accused's earnings during the time the offence was committed.

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After the Supreme Court of Canada ruling in *R. v. Wholesale Travel Group Inc.*,<sup>8</sup> it is clear that where a regulatory offence carries a heavy fine or imprisonment penalty, the Charter does not permit Parliament to statutorily remove the right of the accused to argue in its defence that it exercised due diligence to avoid committing the offence. If a regulatory offence is made

absolute<sup>9</sup> and that defence excluded, the conscientious carrier who makes one mistake is convicted just as surely as the reckless rogue operator. The due diligence defence provides an incentive for transport operators to improve internal compliance with the law. The *NTA, 1987* allows an explicit due diligence defence to transport company directors, but not their companies if the latter are prosecuted. Given the reality of Charter interpretation, it is better that Parliament explicitly recognize the due diligence defence than take the risk that a court would strike down a reckless operator's conviction because this Charter right was not statutorily recognized.



#### **RECOMMENDATION NO. 50**

**We recommend that no absolute liability offences be enacted under the *NTA, 1987*. For each particular offence, the Act should use wording clearly showing either that the offence requires the Crown to prove the accused's intent, or, for reverse onus or negligence offences, that both an individual accused and a corporate accused have the right to demonstrate that they exercised due diligence to avoid committing the offence.**

We have heard that the *NTA, 1987* section 107 procedure to prosecute minor Part II offences before the Civil Aviation Tribunal is impractical. To avoid unnecessary delays and expense in using the general criminal courts for minor offences, the recent federal *Contraventions Act*<sup>10</sup> allows for ticketing of persons committing designated federal offences in a manner similar to ticketing for provincial traffic penalties.



### RECOMMENDATION NO. 51

We recommend that sections 107 and 108 of the *NTA, 1987* be repealed and that prosecution of appropriate *NTA, 1987* offences be conducted under the *Contraventions Act*.

### Openness

The *Freedom to Move* policy statement and subsequent legislation attempted to devise an open and accessible regulatory process. The Agency must determine the public interest while attempting to balance conflicting objectives of being open and ensuring confidentiality of sensitive information.

While we heard concerns that the confidentiality of commercially sensitive financial data must be maintained, in consultations across the country we heard more often that the Agency does not disclose enough information associated with its reasons to allow stakeholders to anticipate criteria by which, for example, rail line transfer and abandonment applications will be determined. Our research indicates that similar uncertainty faces applicants for air service licences where foreign equity participation is involved.

If evidence on the record is not sufficiently available to permit stakeholders to determine what types of proposed commercial arrangements are likely to pass Agency scrutiny, business planning becomes more complex and potential investment is stifled.

If there is no discernible development of criteria in the Agency's reasons for judgment, or improved access to information on which decisions are based, dissatisfied parties are more likely to seek judicial review.

**RECOMMENDATION NO. 52**

Recognizing that the Agency will determine each application on its merits, we recommend that the Agency publish guidelines to foster greater certainty for stakeholders with respect to their regulated activities.

**RECOMMENDATION NO. 53**

We recommend that the *NTA, 1987* be amended to require the Agency to make available to the public all information received in the course of applications and related investigations, excepting only information demonstrated to be commercially sensitive. The responsibility for demonstrating the sensitivity of such information should rest with those providing it.

**Judicial Review**

Parties involved in Agency decisions may seek leave from the Federal Court of Appeal to appeal on questions of law or jurisdiction.

The Federal Court of Appeal has allowed appeals of Agency orders on the grounds that Agency staff had based a decision on information from closed door meetings<sup>11</sup> and where the Agency had required disclosure of internal files by an applicant for rail line abandonment, but not given the railway an opportunity to be heard.<sup>12</sup>

We believe that improved public access to information and a full evaluation of the Agency's role and effectiveness, as we shall discuss below, would ease concerns about the Agency's decision making.

### Cabinet Review

The Cabinet is granted authority to vary or rescind any Agency rule or decision, whether in response to a request or on its own initiative. Any order made in this manner is binding on the Agency and all parties. Although rarely invoked, this process can be used to avoid Agency case law diverging from government policy.

### REVIEWING THE AGENCY MANDATE AND STRUCTURE

During our hearings shippers, carriers and governmental authorities made numerous submissions about the powers and procedures of the Agency. In many cases, concerns were raised at a micro level, often focusing on the timing of procedural steps and the decision-making process. While amendments to procedures are desirable, we consider that a fundamental reassessment of Agency tasks and operations is appropriate. That is to say, the various submissions are concerned with where the trees are planted, but we would like to make certain that the forest itself is sustainable!

### The Implications of Deregulation

The 1985 *Freedom to Move* policy statement was a signal to the Canadian transportation sector that the government was committed to reducing impediments to competition. Since the Agency was charged with overseeing this process, it follows that its procedures and processes should not frustrate attainment of that goal.

In our view, impediments to decision-making arise from the fact that some transportation policies included in section 3 of the *NTA, 1987* are at cross purposes. For example, regional development as a goal of transportation policy may conflict with the goal of competition. In its genuine efforts to satisfy its mandate, the Agency's decision-making in rail line abandonment has been hindered by the need to reconcile disparate policy objectives.

Some submitters' concerns arise from the paradoxical process of regulating deregulation. Various shippers speak in favour of deregulation and competition; the carriers want a consistent administrative process; and other government authorities want more emphasis on their particular concepts of what best serves the public interest.

### The Commission's Perspective on the Agency's Mission

Delay creates uncertainty. Uncertainty is the enemy of investment. Like the *Investment Canada Act*, the statutorily prescribed time limits of the *NTA, 1987* were a response to criticisms of unnecessarily long review processes of its predecessor. Because the Agency's primary role is to facilitate commercial efficiency, it is necessary that it deal with applications before it reasonably quickly. The Agency's procedures must be structured so that they can be accomplished within statutory time limits.

Our overall conclusion from the multitude of submissions made to us is that procedural reform alone will not be sufficient to address the inherent problems created when the Agency was given a mandate to implement apparently conflicting objectives. Simply adding additional unco-ordinated tasks to the Agency's mandate would perpetuate the paradoxical process of regulating the "winding down" of regulation.

Canadian National Railways

*"As the agent of the federal government responsible for the implementation of the National Transportation Policy, one role and responsibility of the Agency is to preserve and facilitate the working of a competitive transportation marketplace, since principles of market-driven competition form the essential basis on which the entire NTA, 87 regime is structured. Yet the Agency is also responsible to intervene and hold back market outcomes on 'public interest' grounds... these multiple responsibilities are irreconcilably in conflict with one another."*

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#### RECOMMENDATION NO. 54

**We recommend that the Agency be given the power to extend statutorily prescribed time limits for rendering decisions only upon the agreement of all parties to the application or investigation.**

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It would be preferable instead to restructure the Agency and to remove unnecessary and duplicative powers. This would have the advantage of clarifying the Agency's mission by removing conflicting objectives. As well, such clarification would address many concerns raised by the Agency's constituents.

Commercial transportation policies and practice are evolving from modal compartments to integrated logistics management. It is thus highly desirable that regulatory structures reflect commercial realities. An explicit mandate over intermodal carriage would assist the Agency in effectively monitoring a rapidly evolving industry and in fashioning appropriate practical remedies for potential disputes. Similarly, it may be useful to consider granting the Agency authority over EDI where it is an integral part of regulated transport undertakings. This could serve to reduce uncertainties in managing such contentious issues as access to computer reservation systems.

We surveyed shippers for their views on the Agency's performance and their overall rating of federal government services to transport. The response rate, in excess of 25%, was quite good for such a survey. Respondents were generally pleased with the federal regulatory scheme, although a few had some concern in the area of branch line abandonment. A large group of respondents were uncertain with respect to various categories, likely indicating that they had not encountered problems.

Among other things, the shippers surveyed want to see stronger Agency representation in western Canada and more co-ordination between agencies and departments. They would like to see the Agency more in contact with small and medium-sized shippers and support some type of government consolidation of transportation regulations to facilitate “one-stop shopping.” These overall comments must be balanced against the views of carriers, who have more qualms about Agency-related matters such as adequacy of reasons for decisions, appeal procedures and disparate mandates like subsidy administration.

In addition, many people volunteered their views to us. Most commented on Agency performance, although their remarks were not always verified. Suggestions have been brought forward to reallocate the Agency’s powers in light of collapsing intermodal barriers in transportation. A variety of proposals have centred on removing functions from or adding new powers to the Agency. Shippers, carriers, the Agency itself and this Commission all have concerns.

Our efforts have centred on the design and application of national transportation policy and legislation, and our analysis has identified a variety of alternatives for clarifying and sharpening the focus of both. We have

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Australian International Air Services Commission Act, 1992

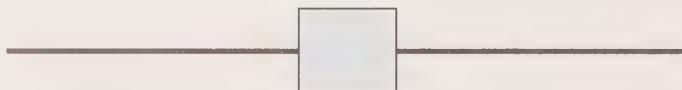
*26. In Performing its functions, the Commission:*

- (a) must act with as little formality as possible; and*
- (b) must act as quickly as is appropriate given the requirements of this Part and the need properly to consider a matter before it; and*
- (c) may decide a matter before it without holding a hearing; and*
- (d) is not bound by the rules of evidence; and*
- (e) may inform itself on anything relevant to a matter before it in any way it thinks fit; and*
- (f) may receive information or submissions orally or by written statements; and*
- (g) may, in respect of a matter before it, consult such persons as it thinks fit.*

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relied on available evidence to support the analysis on which our recommendations are based. Likewise, any contemplated restructuring of the Agency to address the foregoing concerns should be based upon independent empirical analysis.

In fulfilling our responsibility under section 266, we are proposing changes to the Agency's jurisdiction. These changes should proceed without delay. Implementation of administrative changes, however, would be achieved more efficiently if tied to a thorough evaluation of the Agency's performance. The Agency has been in existence for five years without such formal scrutiny. Such an evaluation should comply with Treasury Board guidelines as articulated by the Office of the Comptroller General. More than an audit, this would be an evaluation of the Agency's suitability to carry out its roles and responsibilities.



#### **RECOMMENDATION NO. 55**

We recommend that the Minister of Transport commission an extensive independent evaluation of the Agency. The evaluation should be completed and results reported to the Minister of Transport by no later than March 31, 1994. Among other things, the evaluation should:

- a) examine the Agency's programs, organization and financial and human resources to determine their suitability for the Agency's existing and recommended mandate and objectives;
- b) determine whether the overall results of Agency activities have met the expectations of the clients it serves; and

- c) assess the extent to which the Agency employs the most appropriate, efficient and cost-effective methods in meeting its objectives.

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Both users and the Agency would benefit from an analysis of the resources used in disposition of the Agency's contested caseload since 1987 as compared with the resources anticipated to be required for this purpose at the Agency's inception. The investigation should determine whether the Agency's activities are plausibly linked to objectives and intended results; how well the Agency has performed in fulfilling its legislative mandate; and the extent to which the program might complement, duplicate or overlap other government functions.

### **Regulating More Efficiently**

We have heard concerns that regulating transport undertakings should take into account such goals as environmental preservation. While we have identified the imposition of inconsistent goals on one agency as leading to process inefficiencies, there is no doubt that public objectives beyond those of that one agency exist. The past decade especially has seen the development of environmental review, now required by the new *Canadian Environmental Assessment Act*, as a condition of economic development. It is unlikely that any major transportation undertaking could be achieved today without environmental review. The construction of undertakings such as railway lines also requires approval from the Agency or other economic regulatory authorities.

We have identified the need to facilitate co-operative investment in transportation infrastructure. Having to develop and provide separate submissions to satisfy transportation and environmental regulators compounds the uncertainty for any party seeking approval for a major undertaking. The costs to the applicant are increased and the risk of conflicting decisions exists. The risk to the country is that such disincentives and increased

uncertainties may well dampen investment in infrastructure. Clearly, this would be at odds with the objectives of transportation and economic policy. We believe that the conduct of combined hearings would reduce transaction costs and delays, minimize risks and, accordingly, facilitate investment in infrastructure.



#### **RECOMMENDATION NO. 56**

**We recommend that statutory provision be made for joint hearing boards to conduct, where appropriate, and at the applicant's discretion, combined regulatory assessment by multiple boards.**

#### **ADAPTING TO THE FUTURE**

The law has tended to lag behind development of new technology and business methods. In part, this is due to the systemic conservatism of the legal system and the historic tendency of the Canadian political process to change statutes incrementally in response to pressures. Rapid changes in the world economy and commercial systems pose enough of a risk for businesses and investors in Canada without leaving them to implement change in a legal vacuum or, worse still, a legal framework which has failed to adapt. Will someone be willing to invest in an EDI system for a short line railway when a provincial statute requires a chalkboard schedule at each station?

The introduction of new technology has sometimes left governments without clear legal authority to regulate unforeseen developments. In the 1950s, for example, the Minister of Transport was reduced to invoking the *Navigable Waters Protection Act* to control the routing of a proposed gas pipeline.

Line departments such as Transport or Industry, Science and Technology have policy development functions. Understandably, departmental analysis tends to proceed in the context of familiar distinctions between modes and departmental boundaries. These distinctions are coming to bear little relationship to modern business methods such as integrated logistics management and parallel implementation of marketing, administration and technology.

With the dissolution of the CTC came the abolition of its transport policy co-ordinating mandate. The substitution of Ministerial and Cabinet direction in the *NTA, 1987* has the potential of adaptiveness and flexibility, but in reality means that transport policy is unlikely to change unless problems fester until they burst onto the political agenda. In our view, the Canadian public, shippers and carriers deserve a more proactive approach to transport policy.

Three tasks arise from this need for a more proactive approach:

- a. regular review of the effectiveness and efficiency of existing laws and regulatory procedures;

Government of Alberta

*"The continued opening up of Canadian markets to international trade is increasing the need for Canadian producers, shippers and carriers to position themselves in world markets. Complex, multimodal moves are required, facilitated by a variety of support services such as tracking and customs clearance. Shippers are becoming more concerned with the overall cost and service quality of these multimodal moves than with the details of specific carrier functions. This is especially so for smaller businesses that lack the resources to provide internal logistical support.... In addition to greater integration of policies, the need for innovation suggests a move ahead from reactive regulation towards proactive facilitation. Such an approach requires that transport policies be quickly adapted to reflect the new conditions and stresses rapid deployment of new technologies, R&D, education and job training on the part of industry, regulators, and policy makers."*

- b. continuous monitoring of emerging transport technology and commercial developments; and
- c. creation of a review process for transport innovations which will ensure that legal changes to foster such innovations are identified.

We believe that more focussed attention must be given to co-ordination and development of transport policy among relevant federal departments. In light of our previous policy discussion, we believe that the Department of Transport should address these tasks.

As a general principle, both regulatory and operational statutes should provide a legal framework for emerging transport technologies and ways of doing business. This framework should cover any federal transportation service or undertaking which involves technologies or business methods not envisaged at the time such laws were enacted.

#### **OTHER PROPOSALS FOR CONSIDERATION**

Many submissions, including that of the Agency, proposed a variety of changes to the legislation and regulations. While some of these proposals amount to corrections or clarifications, others are substantive. In the course of our deliberations, we analyzed all proposals for their consistency with our recommendations and the general tenor of this report. A list of such proposals not addressed in our report yet worthy of consideration by the Government of Canada is found in Annex D.

Our recommendations respond to a number of the submitted proposals with the object of adding clarity and efficiency to the legislation. Some of our substantive recommendations affect the Agency's jurisdiction. These are made in the context of the larger perspective of what we believe the legislation and Agency are intended to achieve. It is in this context that we have concerns over the timing of the possible implementation of the appended proposals.

We have recommended a full evaluation of the Agency's operations in light of its structure and suitability for changed responsibilities. During the

time the evaluation is being conducted, the appropriate authorities can consider the merits of the appended proposals. We believe, however, that implementation of the appended proposals should be deferred until the mandate, suitability and structure of the Agency have been reviewed.

The process for legislative amendment implementing our substantive recommendations can be initiated in parallel with the Agency evaluation. When the legislative revision package is ready to proceed, it could include those of the appended proposals which remain relevant after the Agency evaluation.

### NOTES

- 1 *R. v. Crown Zellerbach* [1988] 1 S.C.R. 401, 84 N.R. 1, (1988) 49 D.L.R.(4th) 161.
- 2 *Alberta Government Telephones v. Canadian Radio-television and Telecommunications Commission and CNCP Telecommunications* [1989] 2 S.C.R. 225, 98 N.R. 161, 61 D.L.R. (4th) 193.
- 3 *Ibid.*
- 4 In the context of such recommendation, we consider that the Agency should continue to exercise its domestic and international air service licensing powers under Part II of the *NTA, 1987*. The Minister responsible for Investment Canada would review proposed acquisitions or mergers affecting Canadian air carriers in light of Agency applied tests of voting share ownership and control contained in s. 67 of the *NTA, 1987*. We recommend in Chapter 5 that the percentage of voting share ownership in the s. 67 definition of "Canadian," be adjusted from 75% to 51%. If the structure of a proposed merger or acquisition of an airline were, as determined by the Agency, to take the airline out of the s. 67 definition of "Canadian," so as to cause the airline to lose its eligibility to hold a domestic air service licence, it would be open to the Minister responsible for Investment Canada to find that the proposed investment in the airline was not likely to be of net benefit to Canada. It would also be open to the Minister of Transport to issue a domestic air service licence to a foreign controlled company under s. 73 of the *NTA, 1987*.
- 5 *Chrysler Canada Ltd. v. Canada (Competition Tribunal)*, June 25, 1992.
- 6 *Coronation Insurance Co. v. Taku Air Transport Ltd.* [1991] 3 S.C.R. 622, 131 N.R. 241, 85 D.L.R. (4th) 609.
- 7 [1984] 2 S.C.R. 145, 11 D.L.R. (4th) 141, (1984) 55 N.R. 241.
- 8 [1991] 3 S.C.R. 154, 130 N.R. 1, 84 D.L.R. (4th) 161.

- 9 After the Supreme Court of Canada decision in *R. v. Sault Ste. Marie* [1978] 2 S.C.R. 1299, 85 D.L.R.(3d) 161, 21 N.R. 295, a person or corporation charged with breach of a regulatory statute is entitled to argue that it exercised due diligence to avoid committing the offence. There are two exceptions: absolute liability offences where the language or nature of the legislation does not permit the accused a defence; and offences where the legislation makes it clear that the prosecution must prove that the accused intended to commit the offence.
- 10 S.C. 1992 c. C-47.
- 11 Federal Court of Appeal File No. A-353-89, March 1990.
- 12 Federal Court of Appeal File No. A-1147-88, January 18, 1989.



## Annexes





## ANNEX A

### SUMMARY OF AIR COMPETITION OPTIONS CONSIDERED BY THE NTARC

The Commission examined a range of actions which might be proposed to government in the event of a monopoly developing in the Canadian airline market. Of the six scenarios discussed, three involve expanding service rights for foreign carriers and three others involve investment restrictions.

Two scenarios were endorsed by Commissioners and are recommended in Chapter 5. The decision to include arguments for and against each proposal was made in the hope that these deliberations would be of value to policy makers.

#### CABOTAGE FOR OVERSEAS CARRIERS

##### **Proposal**

Under this option, foreign carriers would be given additional rights in order to restore competition on intra-Canada services.

This option calls for granting foreign but non-U.S. carriers rights to carry local intra-Canada traffic on any international flight serving more than one Canadian point. Thus a Korean Airlines' Seoul-Vancouver-Toronto service could carry traffic flying strictly between the two Canadian cities.

##### **Analysis**

###### *Pros*

The option would allow Canada to obtain more attractive bilateral agreements. Canada could obtain additional rights overseas because of its readiness to trade domestic fill-up authority. Virtually any foreign carrier serving Canada might participate in the intra-Canada market, allowing a wide range

of customer choice. The provision could stimulate Canada's international markets, making otherwise unprofitable overseas flights economical.

### *Cons*

International services usually operate on very narrow "windows," dictated by airport curfews, slot availability, downline connections, time zones and equipment utilization constraints. This severely restricts the domestic timings available.

The wide body aircraft which operate most international services are not cost-effective for the short segments they might fly between Canadian points.

There are major customs and immigration problems. It is not possible to commingle domestic and uncleared international arriving traffic on the same flight.

Non-U.S. foreign operators serve a very limited number of Canadian cities.

Any exchange of domestic cabotage rights could have far reaching implications on Canada's bilateral negotiations. Few nations would have attractive domestic sectors of their own to offer Canadian carriers in exchange.

### **Conclusion**

This option is unlikely to make a significant difference in the level of domestic competition. A decision to grant a foreign carrier intra-Canada fill-up rights should be based on what Canadian carriers would derive from the exchange.

## **LIMITED CABOTAGE RIGHTS FOR U.S. CARRIERS**

### **Proposal**

This option is similar in principle to the previous suggestion and looks to U.S. based airlines to provide a counterforce to the monopoly. It calls for

airlines of the United States to carry strictly intra-Canada traffic on any trans-border flight serving more than one Canadian point.

## Analysis

### *Pros*

The transborder and Canadian domestic markets use similar aircraft types. Those planes now flying transborder routes have the technical characteristics appropriate for operating intra-Canada segments. Both markets are roughly similar in terms of customer demographics and purchase preferences. Thus U.S. carriers already have much of the market understanding needed to succeed. Most U.S. carriers are already well established in Canada and enjoy considerable market credibility. Both the transborder and domestic markets are frequency-sensitive, and require at least daily flights. Transborder extensions thus could be operated at high frequencies, subject to scheduling factors.

### *Cons*

The above reasons all suggest that U.S. carriers would be more successful than overseas operators in developing an intra-Canada market. Nevertheless, such services would face several hurdles.

The new U.S. bilateral would likely include a phasing formula to protect Canadian carriers. For the first few years of the agreement, U.S. carriers would obtain only limited access to Montreal, Toronto and Vancouver. These protective measures would make it difficult for U.S. carriers to mount a credible intra-Canada product in Canada's three largest markets, unless Canada chooses to waive these restrictions unilaterally.

U.S. carriers have expressed little interest in intra-Canada cabotage rights. This may be simple posturing, to dissuade the United States from granting domestic rights to foreign carriers. However, it may be difficult for Canada to obtain an acceptable quid pro quo from the United States.

The proposal could dilute the airlines' transborder products. To fly an intra-Canada leg, the airline would have to serve one Canadian city with a

one-stop flight from its hub in the United States. This could render its trans-border service from this point non-competitive.

The proposal would encounter serious complications because of the commingling of domestic and transborder passengers on intra-Canada legs. Southbound preclearance would exacerbate these problems.

The proposal would not help smaller communities. It would only enhance competition on a selected few long distance and high traffic routes. No U.S. carrier could provide a comprehensive multi-destination product to even one Canadian city.

The long haul high volume routes most likely to be served by U.S. carriers are the most critical to all-new industry entrants. If U.S. carriers are permitted to launch intra-Canada services, it may be more difficult for new indigenous carriers to enter the domestic market.

### **Conclusion**

Because of these concerns, it is unlikely that granting U.S. carriers intra-Canada fill-up rights would provide an effective counterweight to the emerging domestic monopoly. U.S. carriers would probably not begin short haul intra-Canada legs, since they would not offset the aircraft utilization, scheduling and customs clearance problems. They would continue to offer a predominantly nonstop-to-a-U.S. hub transborder product.

Granting U.S. carriers intra-Canada fill-up rights would be a pro-competitive step. However, this measure would only provide a marginal increase in competition at best, and would fall well short of providing an effective counterweight to the Canadian domestic monopoly.

The concept might lead to U.S. carriers "cream skimming" the long distance and high volume routes. This could be particularly detrimental to new entrants. However, the U.S. carrier could not provide a comprehensive service based on intra-Canada fill-up rights.

## INDIRECT SERVICES THROUGH U.S. GATEWAYS

### **Proposal**

This proposal calls for allowing U.S. carriers to serve Canadian domestic traffic using their existing transborder networks. Under the plan, Toronto-Vancouver passengers might, for example, travel via Minneapolis, Detroit or Chicago.

### **Analysis**

#### *Pros*

Several factors suggest that the plan could provide the travelling public with an alternative to a domestic monopoly.

Several U.S. hubs are located close to the great circle tracks connecting major Canadian cities. A stop at Minneapolis would add only 48 kilometres to a Toronto-Vancouver flight. A stop at Chicago-O'Hare would call for a 186 kilometre detour. Detroit and, to a lesser degree Cincinnati and Pittsburgh, are also potential hubs for Canadian domestic passengers.

U.S. carriers are already well known and accepted by Canadian travellers. Their existing transborder networks, and the enhancements resulting from a liberalized U.S. bilateral, provide a ready-made conduit for Canada's domestic passengers.

Flight scheduling at the hubs would support an intra-Canada product.

#### *Cons*

Because of the phase-in provisions of the new Canada-United States bilateral, U.S. carriers may be constrained in their services to the three largest Canadian points, limiting their ability to offer an attractive product.

The proposal would be ineffective for short haul intra-Canada routes. No U.S. point could, for example, offer an attractive routing between Montreal and Toronto or Calgary and Edmonton.

The U.S. carriers under this plan would be restricted to a one-stop-through-a-hub Canadian product. Most Canadian city-pairs have sufficient

traffic to justify nonstop services and the airlines appear to view nonstop services between the major cities as prerequisites for a competitive service. Even under a complete domestic consolidation, the major city-pairs will continue to receive nonstop services. The U.S. carriers would then compete only for the low fare, price-elastic segments of the intra-Canada market. It is unlikely that they would pursue this traffic aggressively.

Canadian domestic passengers transiting the United States would have to clear entry formalities twice, for entering the United States and returning to Canada. This would reduce the appeal of the service and increase the burden on inspections staff and facilities.

Smaller Canadian cities, especially in Atlantic Canada, may not benefit. Even with a liberal bilateral, it is unlikely that most communities would obtain services to the critical hubs in the Ohio Valley or the Midwest. There are no U.S. hubs well positioned to serve markets such as St. John's-Montreal or Halifax-Toronto. The proposal would mostly aid Ontario-Quebec-western Canada passengers.

## Conclusion

The proposal could provide short term relief to a domestic monopoly. However, allowing large and aggressive U.S. carriers to develop a presence on Canada's domestic routes could complicate entry for all-new airlines in the future.

This proposal would allow a degree of competition on long distance high density routes. While it would be of little direct benefit to time sensitive business travellers, it would help retain alternatives for discretionary passengers.

The concept would provide the greatest stimulus for high volume, long distance markets such as Toronto-Calgary/Edmonton/Vancouver. It would offer little or nothing to small communities or short haul markets. It would provide few benefits to Atlantic Canada.

## RELAX THE FOREIGN OWNERSHIP LIMIT

### **Proposal**

Under this option, Canada would raise the 25% ceiling on foreign equity participation to some unspecified limit.

### **Analysis**

#### *Pros*

A liberalized ownership rule might allow the emergence of a new domestic competitor based heavily on overseas capital.

Relaxing the rule could be an important prerequisite for allowing Canada's airlines to develop alliances with foreign carriers; these increasingly involve large equity swaps.

#### *Cons*

The industry fundamentals: overcapacity, weak demand, structural uncertainty, and high costs; could make it an uninviting target for foreign investors. The poor rate of return, not the ownership rule, is the element which now restricts airline access to any capital, foreign or Canadian.

A large and aggressive monopolist could make entry difficult, deterring new entrants and foreign capital. Changing the ceiling may have no effect.

If the industry can eliminate the problems of overcapacity and low productivity, it could probably obtain sufficient capital from Canadian markets.

### **Conclusion**

Relaxing the ownership rule is unquestionably a pro-competitive measure, since it would give all Canadian airlines, existing and potential, greater access to capital. There is no clear economic reason *not* to raise the limit. But there is no assurance that raising the ceiling would ameliorate the short term problems resulting from a lack of domestic competition. The issue must therefore be resolved within the broad context of a national aviation policy.

## FOREIGN CARRIER RIGHT OF ESTABLISHMENT

### **Proposal**

In the event of a monopoly, Canada would allow foreign carriers to fill the competitive vacuum. Under this proposal, foreign airlines would be permitted to establish stand-alone operations within Canada. These could be operated either by the airline itself, a separate division, or a subsidiary. The proposal thus would be the equivalent of removing any ownership limitations. It necessarily implies that foreign ownership restrictions on existing carriers would also be removed.

The proposal would have different implications for firms based in the United States and those headquartered overseas. Several elements such as name recognition, and fleet suitability, would favour the U.S. airlines.

### **Analysis**

#### *Pros*

Flexibility. Several alternatives are possible. Canada might restrict this privilege only to those foreign carriers not serving Canada. This would prevent the airlines from integrating its intra-Canada and international services to obtain traffic feed from the Canadian hinterland. This benefit is the strongest advantage Canadian carriers have on international flights. Canada could also license only those foreign capitalists who do not have large airline holdings in other countries. For example, it may welcome a British investor's funds to establish a truly Canadian operation but may not want to approve a Canadian subsidiary of British Airways.

The plan would accommodate the trend towards international marketing alliances and equity swaps. It has been proposed that the world is evolving towards a handful of mega-carriers. The right of establishment is the only effective means to assure that all of the new companies which may result could serve intra-Canada markets. If there is no suitable Canadian partner or acquisition target, a mega-carrier could not otherwise establish intra-Canada operations.

By exposing them to potentially domestic unlimited competition, the plan would require Canadian carriers to become far more cost-effective. This would result in lower fares and higher international competitiveness.

The plan could introduce new criteria for licensing airline services in Canada. Current approaches emphasize country of ownership and control, but neglect broader economic factors. Canada could select foreign airlines to operate domestic services based on the size of their investment or the number of Canadians they would employ. These criteria now govern many non-airline investments.

#### *Cons*

If Canada attempts to restrict the right of establishment, it may be open to charges of discrimination.

Canada could face hurdles if it decides to designate the foreign carriers based in Canada on international routes. Most bilateral agreements have a "substantial ownership and effective control" restriction on airline route designations.

The Canadian market may not be attractive to a foreign investor under the current regime of overcapacity.

An all-new carrier could face important entry barriers. It may view flights on only a few city-pairs as insufficient, but would seek to develop a comprehensive Canada-wide product. It would everywhere face a well entrenched carrier with a comprehensive schedule and extensive feed from international and domestic routes. It might view this as an insurmountable obstacle.

The airline industry faces periodic gluts of capacity. During the current crisis, many airlines have idle aircraft. If Canada were to allow unrestricted entry by foreigners, it might be periodically flooded by the world's surplus equipment. This would magnify the industry's already serious economic instability.

Allowing foreigners the right of establishment would be a unilateral action by Canada. It is unlikely that other nations would reciprocate.

Since an airline could undertake many of the activities necessary to serve the Canadian market in another country, the proposal would exacerbate any problems arising from international tax differentials. It would become especially important for Canada to harmonize all relevant taxes to those of the United States.

### **Conclusion**

The proposal would allow the world's most formidable carriers to establish independent operations in Canada. It would have significant implications for Canada's ability to maintain a Canadian owned airline industry. However, it would be a very effective means to restore competition on intra-Canada routes.

Canada could maximize the economic benefits it receives through awarding domestic licences on the basis of national economic benefit. In taking these bold steps, Canada would be the first nation to replace its policies of aviation mercantilism with the economic pragmatism. Only through this strategy could Canada ensure that its air services are responsive to broad global trends.

## **DIVEST REGIONAL AFFILIATES**

### **Proposal**

This option assumes that Canada would approve an Air Canada/Canadian Airlines International merger proposal. Under this plan, the newly merged entity would be forced to divest some or all of its regional carrier holdings. The newly independent regional airlines would then provide a new set of competitors which would counteract the monopolistic affects of the merger.

### **Analysis**

#### *Pros*

The second tier carriers have become a large and dynamic industry force. Many members operate jet equipment on trunk services, such as Halifax-St. John's, Vancouver-Kelowna and Calgary-Victoria. In some instances, they fly

the same segments as the senior partners and play an important role in offering a comprehensive spectrum of services. They also are active on trans-border charter services. These elements suggest that they could provide a competitive force.

Most Canadian cities already are served by two regional carriers. If all the regional carriers survived the divestiture, virtually every Canadian city and important regional route would have at least two competitors.

### *Cons*

The regionals' ability to exist independent of their senior partners is questionable. They presently depend on the trunk airlines for many different services; product branding and identification, promotion, purchasing, management information and other functions. At best, as independents, they would incur much higher overheads.

A regional affiliate is almost totally dependent on its mainline partner for traffic feed. As an independent, it would no longer have a source of guaranteed feed and would face difficult obstacles in negotiating revenue sharing agreements with the major trunkline carrier.

Air Canada and Canadian Airlines International have virtually identical feeder systems; with the same routes and schedules radiating from the same hubs. If the two major airlines merge, one large mainline carrier would be negotiating with two regional feeders at the major hubs. The possibilities for the newly merged trunk carrier to play off the regionals for traffic feed would be virtually endless. That regional carrier unable to negotiate an acceptable agreement for feed would almost certainly fail.

The employment and productivity gains of the affiliates have been the most important success story of the ERR program. A forced divestiture of the mainline monopolist, through threatening this segment, might forfeit many of the greatest gains of the liberalization process.

It is unlikely that many regions could support two regional carriers. One would almost certainly fail.

## Conclusion

The regional carriers might be successful despite the above. However, they would still face an urgent need to obtain a secure source of long haul traffic feed. The most likely scenario would see a merger of the regionals, and a rapid initiative to develop a long haul presence. This would require the purchase of a long haul fleet of aircraft whether or not total market demand justified it, and a growth in the airline's cost and debt levels. This is virtually the same process PWA Corporation followed in acquiring CP Air, the regional carriers and the long haul fleet. It was these actions which have contributed so pivotally to today's dilemma.

For these reasons, forcing the newly merged entity to divest of its regional affiliates would likely be counter-productive. It could greatly weaken the regional carriers, a dynamic and growing sector of the industry. At best, it could merely lead to a repetition of past mistakes and a repeat of the current industry crisis within the next decade.



## ANNEX B

### SUMMARY OF COMPETITIVE LINE RATE (CLR) PROPOSALS CONSIDERED BY THE NTARC

Many proposed alterations to the current CLR mechanisms were debated by the Commission, and nine are analyzed here. Where Commissioners endorsed a change, it is reflected in a recommendation in Chapter 5. The analysis of each of these proposals is reproduced here in the hope that it will be of interest to policy makers.

#### CLR RATE FORMULA

##### Proposal

A number of shippers have proposed that the section 137 "rate formula" provision of the *NTA, 1987* be modified to ensure the generation of low CLR levels. Their essential argument is that, if left unchanged, sections 137(3), (4) and (6) could be applied to set the amount of CLRs at an unreasonably high level.

##### Analysis

The CLR was designed to break any "monopoly privilege" enjoyed by a railway as a result of local shippers being captive to its lines. In cases where a railway and captive shipper cannot agree on a rate, a CLR may be imposed on the railway in accordance with section 137 formulae. The intent of the legislation is to have a rate imposed which would reasonably approximate that rate which would have prevailed under conditions of intramodal competition.

Experience with CLRs so far suggests that the intent of the legislation has not been realized. The National Transportation Agency has not been able to rely on the complex formulae of section 137 and has resorted instead to section 142 which provides the Agency discretion to set rates according to its

own criteria. Observers have suggested to the Commission that this discretion has allowed the Agency to impose very low, barely compensatory rates. This may be attributable to several factors, including the use of factitious destinations and the involvement of U.S. destinations in all CLRs set to date.

While there appears to be some logic in the arguments raised by these shippers, the Commission believes that none of their proposed rate formula solutions is fully workable or able to be endorsed.

### **Conclusion**

Given the intent of CLRs and the fact that their rate formula provisions appear to fall short of their intended mark, we have recommended that section 142 be repealed and section 137 be amended to require that the Agency establish CLRs that are commercially fair and reasonable (i.e. CLRs that match the revenue a local carrier would have achieved under intramodal competition).

## **FACTITIOUS DESTINATION**

### **Proposal**

To obtain a CLR, a shipper must first obtain a rate quotation from a connecting carrier which carries the cargo from its connection with the local rail carrier on which the CLR to be applied for is imposed. For various reasons some shippers have requested rate quotations from connecting carriers to a point less distant from the point of origin than the ultimate destination intended for the goods. Such point is known as a factitious destination.

Canadian National Railways and CP Rail have proposed to the Commission that the use of factitious destinations be prevented. They argue that shippers, by stating factitious destinations involving artificially low rates arranged with connecting carriers, have abused the CLR provisions of the Act. These railways further argue that the result of the actions described is to depress the level of CLR rates.

## Analysis

In the case of at least one CLR, a factitious destination was used which resulted in an extremely low rate. Such use of factitious destinations could be construed to be an abuse of the CLR process.

On the other hand, shippers can counter with the argument that, where movement by a connecting carrier is covered by a confidential contract, it is necessary to state a factitious destination. Even if true, the argument is academic in that the local rail carrier handling the traffic probably knows the destination of the movement in question.

## Conclusion

We believe that a shipper requesting a CLR should be required to declare whether the stated destination is factitious and that in such cases the connecting carrier rate should not be considered by the Agency in developing a CLR. Consequently we have recommended that section 134 be amended to require that:

- i) in applying for a CLR, the shipper disclose if its designated route has a factitious destination; and that,*
- ii) on such disclosure being made, the Agency disregard the amount of the connecting carrier's rate in establishing a CLR.*

## DESIGNATION OF INTERCHANGE

### Proposal

Some shippers have proposed to the Commission that the Act be modified to permit shippers to designate interchanges and routes which they find the most competitive and efficient. This would require substantial changes to sections 134(2) and (7).

### Analysis

In reviewing the arguments made in support of this proposal, the Commission was convinced that implementation of the proposed changes would enable shippers to dictate virtually any routing for a CLR.

CLRs were designed to enhance competition, and the Act specifies the "nearest interchange" in order to require the local carrier to carry the traffic only the shortest distance. By allowing the shipper to designate the nearest interchange, the opposite effect could result. The potential exists for shippers to designate a distant interchange if that would be more advantageous. In essence, the result would be that a shipper served by only one railway could be granted something not available to shippers with a competitive rail service.

### Conclusion

Adoption of such proposal could result in more costly and less efficient rail operations. That would be contrary to both the spirit and intent of the NTA, 1987. The Commission accordingly sees no reason to alter the current provisions regarding designation of interchange.

## INCLUSION OF TRAILERS ON FLAT CARS/CONTAINERS ON FLAT CARS (TOFC/COFC)

### Proposal

Some shippers have advocated removal of the provisions of the Act which preclude the use of CLRs for intermodal traffic (trailers on flat cars/containers on flat cars). These shippers argue that the removal of such provisions would lead to greatly increased rail intermodal traffic.

### Analysis

In the U.S. legislation, TOFC/COFC is completely exempt from regulation on the grounds that such traffic is sufficiently competitive. Given the inherently competitive nature of this type of carriage, we find it difficult to conceive how it might be captive to a railway.

The application of CLRs to this type of traffic to and from a port was made in response to concerns of the Port of Halifax which argued that long haul container movements to and from central Canada were uneconomical by truck. Experience, however, reveals that the CLR mechanism has proven neither effective nor necessary to protect container movements to and from the Port of Halifax.

### **Conclusion**

We believe that being inherently competitive TOFC/COFC movements should continue to be precluded from the ambit of CLRs. As it is a minor anomaly of no real benefit, however, we believe that the "traffic to/from a port" exemption from this rule should be ended. Consequently we have recommended that section 135(3) be amended by repealing the words 'unless the containers arrive at a port in Canada by water for further movement by rail or by rail, for further movement by water.'

## **CLRs AT ORIGIN AND DESTINATION POINTS**

### **Proposal**

The Coalition of Concerned Shippers has argued to the Commission that because the Act limits rail movement to one CLR only it prevents a shipper from selecting the most efficient routing of its traffic and thus inhibits competition. These shippers proposed that the Act be amended to permit a CLR at both ends of a move.

### **Analysis**

The CLR mechanism cannot be of use if both the shipper and consignee of a rail movement are local to the same railway. Given the apparent reluctance of Canada's major rail carriers to compete by offering connecting carrier quotations for CLRs, it would be difficult to envisage how the CLR provision would facilitate movements entirely within Canada.

The Commission recognizes, however, that unlimited provision of CLRs at both ends of a move could divert long haul domestic traffic to U.S.

"bridge carriers" which are unconstrained by reciprocal competitive access arrangements with Canadian railways. Section 134(5) of the *NTA, 1987* was intended specifically to limit such movements.

### **Conclusion**

While the Commission recognizes the meritorious aspects of the shippers' proposal, at the same time we wish to guard against the erosion of Canadian railway revenues. As a result, we have recommended that section 135(6) only be amended to provide that CLRs for a routing through Canada may be set for both origin and destination points if both shipper and consignee are captive to the same railway company.

## **CLR TIME LIMITS**

### **Proposal**

Shippers have proposed that a maximum three-year time limit be allowed for CLRs, arguing that the one-year limit presently contained in section 139 of the Act is too restrictive. They argue that in some cases, for example, the possible use of a CLR could be inhibited if investment requirements necessitated a rate for longer than one year.

### **Analysis**

The Commission has learned that the intent of the one-year limit was to encourage both parties to negotiate. In the event that negotiations failed and a CLR was imposed, a new negotiation would be automatically required in one year.

The Commission has not heard any compelling arguments relating to what investment might be required in connection with a CLR. Nor has a convincing argument been made to explain why the process of reapplying for and renewal of a CLR places a burden on shippers.

In any event, the Commission believes that circumstances could arise where a request for a CLR extending beyond one year could be reasonable (perhaps, for example, for payback of an investment in required specialized

cars). Consequently the Agency should have the flexibility to respond if the case for extension can be proven by the shipper making application. It would be open to the Agency to include inflation adjustment provisions in multi-year CLRs.

### **Conclusion**

Given the fact that circumstances may arise which warrant the setting of a CLR for a period extending beyond one year, we have recommended that section 139 be amended to provide that on initial application for a CLR, the Agency may set a CLR for a period of up to three years if the shipper proves a demonstrable need for a CLR longer than one year.

## **RESPONSIBILITY FOR CAR SUPPLY**

### **Proposal**

The railways have proposed that the Act be amended to remove a clause which could create a disadvantage for local carriers by obliging them to supply cars. The argument is that local carriers might be obliged to tie up cars in a low return service, effectively denying them the opportunity to earn higher returns in a commercial service.

### **Analysis**

The *NTA, 1987* presently stipulates in section 140 (1) that, where railways supply cars, the obligation to supply cars rests with the railway enjoying the major portion of the movement. Theoretically, a local carrier could end up with the major portion of a movement involving a CLR, especially in a case where the shipper specifies a factitious destination.

The intent of the CLR is to remove the potential for a local carrier to enjoy "monopoly privilege" on its fixed plant. A CLR imposed on a railway would clearly reduce the return which that railway could achieve on its fixed plant. While such a provision seems commercially intrusive, the Commission understands the rationale that it is necessary to achieve competition where such a state might otherwise not exist.

The Commission is not convinced, however, that the obligation to supply cars should rest with the local carrier where the associated rate is regulated and, necessarily, relatively low. Logic suggests that, in such a case, the obligation to supply cars must remain with the connecting carrier, which has commercial rate-making freedom. This would not hold, of course, where the shipper supplies cars.

Because of the recommendation that section 135(6) be amended to allow double-ended CLRs, and the continuing possible use of a factitious destination, the major portion of the movement is no longer an appropriate criterion for allocating responsibility for car supply.

### **Conclusion**

Given the arguments we have considered, and the intent of the CLR mechanism to encourage competition, we have recommended that section 140(1) be amended to clarify that the carrier on which a CLR is imposed is not required to supply cars for the traffic being moved.

## **EXEMPTIONS FROM REGULATION**

### **General Exemptions**

#### **Proposal**

It has been proposed by Canadian National Railways and CP Rail that the *NTA, 1987* be modified to enable the Agency to make exemptions from regulations where it can determine that market competition exists sufficient to remove the need to regulate. The railways proposed that provisions similar to those of the U.S. *Interstate Commerce Act* s. 10105 be enacted to exempt from regulation in such circumstances specific classes of traffic, specific types of movements or specific commodities. They further propose that an exemption could be initiated by a shipper, a railway, the Agency or an interested party.

## Analysis

The railways' arguments are based for the most part on the success of regulatory exemptions in the U.S. environment. The theoretical expectations, however, do not translate to reality in the Canadian context. It is unlikely that large segments of the Canadian railway market currently offer satisfactory enough levels of competition to warrant such exemptions. With increasing rationalization of the Canadian rail network, the potential for competition between main line rail carriers may decrease. Canada's population density is lower than that of the U.S. In addition, the Canadian transportation system is far less extensive than the American system, and many resource shippers are located in remote locations.

While arguments relating to the U.S. experience are essentially logical, there is no evidence that in the Canadian context a general exemption program would have the same success. Moreover, the Commission has some reservations about creating opportunities for rail carriers to selectively target specific areas or traffic situations while ignoring others. General exemptions might lead to more unexpected problematic circumstances than specific exemptions would.

## Conclusions

Given the significant differences between the U.S. and Canadian transportation markets and the potential for unintended effects of selective actions, the Commission remains unconvinced that provisions for general regulatory exemption are called for at this time in Canada.

## Specific Exemptions

### Proposal

Canadian National Railways and CP Rail have proposed to the Commission that they be permitted to obtain exemptions from competitive line rates in situations where shippers enjoy "effective competition." CP Rail further proposes, as a safeguard against a railway delaying legitimate shipper requests for CLR relief, that the railway be required to demonstrate the existence of

effective competition without significantly extending the time required in the proceedings.

### Analysis

The CLR mechanism is rarely used directly by shippers. In spite of this, the Commission perceives that shippers would likely resist change aimed at possible specific exemption from CLRs based on their experience with existing and previous regulation. There is merit, however, in considering the topic of specific exemptions from CLRs.

Based on experience with section 23 of the *NTA, 1967* there is some validity to shippers' concerns that railways might use a specific exemption process to thwart the usefulness of the CLR provisions. Section 23 was vulnerable to attempts to draw out proceedings through legal process, thereby effectively limiting the usefulness and timeliness of then existing shipper remedies.

To ensure that the possibility of specific exemption from CLRs would not be open to similar abuse, it would be necessary to place the onus of proof of effective competition on the railway and to carefully circumscribe the time limits for railway action (say, 7 days) and Agency decisions (say, 15 days). To further ensure that the exemption process would not be abused, the Agency would have to be required to publish criteria for effective competition in advance.

### Conclusion

The railway arguments are not without merit, and adequate safeguards might be developed, in the form of time limits and onus of proof on the railways for a program of specific exemptions from CLRs, to co-exist alongside shippers' concerns for the existence of effective competition. As regards CLRs, however, perception is reality and any present limitation of their potential availability could be premature. The primary utility of the CLR provisions is to provide some leverage to shippers in the bargaining of confidential contracts and their value is largely a function of perception. For this reason, although

we believe that under certain conditions (as discussed above) a specific exemption program could be implemented effectively, Commissioners could not agree as to whether circumstances warrant such a change at this time.

## **COMPETITIVE ACCESS PROVISION FOR PROVINCIAL RAILWAYS**

### **Proposal**

A number of shippers have proposed generally that federal and provincial railway regulatory regimes be harmonized. They have proposed specific action to make competitive access provisions available to shippers located on provincial railways. As regards CLRs particularly, their proposal would designate the point of interchange with a federal railway as the point of origin or destination, so that a CLR might be imposed on the connecting federal railway.

### **Analysis**

There are two types of railways under provincial regulation — the historic regional railways and the newer short line railways. The general problem of providing competitive access to shippers is the same in both cases. The regional railways generally set their own rates, or receive a negotiated division of through rates for traffic originating or terminating on their lines. They are full parties to the through rate. Short lines, on the other hand, may be full parties to a rate, but are often not involved in the development of through rates. More often, short line railways receive a per car interswitching payment from the connecting mainline carrier.

A proposal to designate the interchange with a federal railway as the point of origin or destination for imposing a CLR is essentially unfair. As provincial railways are beyond federal regulation, they would be under no obligation to co-operate to produce the result desired by the shipper. While the true originating (or terminating) carrier would be free to charge a commercial rate, the connecting federal railway would be subject to rate regulation.

The Commission believes that the means of addressing such above described potential inequities is to harmonize federal and provincial railway regulatory schemes. In this way, the competitive access provisions would apply equally to federally and provincially regulated carriers without one or the other carrier being disadvantaged.

### **Conclusion**

We believe that it would be desirable for the Minister of Transport to establish a federal-provincial co-ordinating body to harmonize economic regulation of federal and intraprovincial railways so that analogous competitive rail access and freight rate rights are available to shippers on the lines of either type of railway.



## ANNEX C

### DISCUSSION OF FINAL OFFER ARBITRATION IN THE *NTA, 1987*

The Commission debated the Final Offer Arbitration provisions at length, and offers the following discussion and proposed model for the use of policy makers and members of the general public.

The *NTA, 1987* gave the Agency an expanded role in mediating and requiring arbitration of disputes arising out of disagreements over rates and conditions. This reflects a growing interest in alternate dispute resolution as a means of speeding decision making and reducing delays and expense. Participation by carriers or shippers in mediation is voluntary.

Under the present law, a shipper may request final offer arbitration (FOA) for goods to be carried by domestic air services or by rail, other than grain movements under the *Western Grain Transportation Act* or rail carriage of trailers or containers.

The Agency may convert a shipper's FOA request to an Agency investigation. In FOA, both shipper and carrier submit their final best offer in writing and the private arbitrator must choose between the two. The arbitrator's choice is final for one year unless shipper and carrier agree to extend the arrangement. The chosen rate must be published in the carrier's tariff unless the dispute arises from confidential contract negotiations.

#### HAS FOA WORKED?

It was envisaged that FOA would be a quick and inexpensive alternative to public hearings as a means of resolving rate disputes. It has not been used for this purpose. Although few have resorted to final offer arbitration, many shippers have urged that it be kept because it helps negotiation of confidential agreements. They have contended that the appeals of a recent FOA award

may have the effect of deterring arbitrators from agreeing to hear FOA disputes and therefore has limited FOA as a bargaining lever. Carriers have expressed concerns that the FOA process not be applicable where competitive transport services exist or be used to impose unfair rates.

Despite the present section 112 requirement that all rates be compensatory, the FOA scheme does not contain any requirement that each final offer must be at least compensatory. This could place arbitrators in a dilemma if the carrier submits an unreasonably high offer and the shipper submits a non-compensatory offer. If in such a situation arbitrators feel compelled to choose the carrier's offer, the FOA process may favour carriers because of their better access to costing information. The small shipper could face the unpleasant prospect of paying higher rates to avoid the risk of its uncompensatory offer being rejected, or face the expense of hiring experts to more accurately cost its final offer.

### **IMPROVING THE FOA PROCESS**

We are recommending repeal of the section 112 requirement for compensatory rates. This recommendation raises two issues. Ought a rate imposed by a regulatory scheme be required to be compensatory? How would any imposed limit on the scope of offers work in practice? We consider that the interests of all participants in the transportation system are best served by the more equitable standard of commercial reasonableness. To enhance the integrity of the regulatory process, the current absolute FOA procedure needs modification permitting the arbitrator to set a more commercially reasonable rate than either party proposes.

As market forces should govern transportation generally, the integrity of the regulatory process also requires that FOA not be applicable in transportation markets where competitive alternatives are available. We recognize that shippers without effective competitive alternatives may need legal mechanisms to compete with shippers who do have a transport choice. However, shippers with a transport choice ought not to be able to invoke a regulatory process simply for bargaining purposes.

The present Agency FOA option of a public interest investigation is impractical for the resolution of rate disputes between particular shippers and carriers. Those who see one rate dispute as symptomatic of wider public issues are free to use the existing alternative of a complaint under section 35. The existing Agency investigation role under the FOA provisions should be replaced by an Agency role in determining whether effective competition is available to a shipper.

Although the Agency should assume this role, to avoid delays for the shipper who in fact faces an uncompetitive market, proof of competitive market forces should rest with the carrier, with short procedural time limits. In demonstrating the existence of a competitive market, the carrier should be required to show that alternate carriers or modes are logically practical as well as economically priced.

To ensure certainty and encourage free bargaining, it is essential that the Agency publish and regularly update criteria for determining both what constitutes an effective competitive market and how a commercially reasonable rate may be determined. These criteria should be developed through extensive industry and public consultation. These criteria could include the rate offered by carriers for similar commodities in competitive transport markets.

Published criteria would have the additional important advantages of minimizing successful judicial review of the FOA process. With clear criteria, arbitrators would have the comfort of knowing that their decisions could not be challenged as beyond their intended jurisdiction. We believe arbitrators should make use of their present right under section 49 (2) to draw on the technical expertise of the Agency. We are satisfied that, despite our recommendation that confidential contracts not be filed, the Agency would have access to ample statistical information to assist arbitrators.

While appeal from the Agency's decision would remain possible, the frequency of such Federal Court appeals could be reduced by tying shippers and carriers to their submitted positions and further reduced as a result of

the Agency's published criteria for determining the existence of effective competition for the purpose of FOA applications.

We believe any FOA process could not work with a compensatory rate requirement alone, because shippers would have an incentive to subject all carrier rate quotations to FOA, knowing that every commercial rate above cost would be reduced by the process. Further, with our recommended abandonment of compensatory rates in general, a compensatory rate test confined to FOAs would have the effect of penalizing captive shippers where their non-captive competitors may pay non-compensatory rates due to market pressure. For example, an isolated Canadian shipper may be captive to one carrier, while other Canadian shippers of the same product may have access to competitive transport services. While avoiding monopoly abuse, FOA should create as little market distortion as possible. We conclude that commercial reasonableness is a more equitable rate criterion for all parties.

### A PROCEDURAL FRAMEWORK

1. As at present, the shipper would request an FOA from the Agency, on notice to the carrier. The shipper's request would include general grounds for believing effective competition does not exist. The carrier would have a short time period to prove the existence of effective competition to the Agency. If the Agency determines competition exists, the FOA application is terminated. If the Agency finds effective competition does not exist, the FOA proceeds.
2. If the Agency found inadequate competition, the arbitrator would proceed to hear evidence and receive the final offers. If one offer is determined to be commercially unreasonable, the arbitrator must accept the commercially reasonable offer.
3. If the arbitrator were satisfied that both offers were commercially reasonable, he would be required to choose one of the offers, as in the present scheme.

4. If both offers were to be determined commercially unreasonable, the arbitrator, with Agency technical assistance as necessary, would determine and set a commercially reasonable rate.
5. FOAs that continue through to an arbitrator's decision should continue to be final without right of appeal.

### **CONCLUSION**

We do not believe that our proposal would make the Agency more intrusive than at present. As we have concluded that a statutory right should not be used as a tool to impose uneconomic rates, it is appropriate that the Agency monitor access to FOA. Private arbitration of rate disputes remains available under general law, without resorting to the FOA process. As carriers and shippers become more interdependent in integrated logistics management, there will be systemic commercial incentives to bargain and settle disputes privately. The FOA process would remain available to protect the captive shipper.





## ANNEX D

### OTHER PROPOSALS FOR CONSIDERATION

#### *NATIONAL TRANSPORTATION ACT, 1987*

Section or Part	Comment
1	Amend the short title of the Act to read “ <i>National Transportation Act</i> ” by deleting the reference to 1987.
4	Amend definition of “goods” to read “freight, rolling stock and mail.”

#### **PART I — NATIONAL TRANSPORTATION AGENCY**

6(1)	The Agency should be a broadly representative body with constituent representation.
18(2)	The English “time” of deposit should be changed to date to correspond with the French text.
20(5)	Allow the taking of evidence in foreign parts in Agency hearings.
25	Insert “visées à l'article 24” before “devant” in the French version to correspond with the English.
27	Provide for procedures which are informal and expeditious, that considerations of fairness be overriding, and that the Agency not be bound to adhere strictly to the rules of evidence.
35(4)	The English text should be brought into line with the French to clarify the limits on Agency power intended by Parliament.
37(2)	Correct the spelling of “jurisdiction.”
38(3)	This subsection should be a separate provision as it is not logically connected to 38(1) and (2).

41 Give the Agency the authority to make minor changes in orders without a full review of the decision.

45 Clarify that the Agency may make its own determination as well as requiring a carrier to declare the proportions of intermodal rates applied to each mode of transportation.

46 Amend section to provide for mediation of any transportation dispute under the Agency's jurisdiction.

47 Amend section to eliminate restrictions on arbitration of intermodal traffic.

47(b) Repeal subsection (ii).

65 Provide the Agency with the right to be heard in any court in which there are proceedings involving the Agency.

## PART II — AIR TRANSPORTATION

67 Define "publicly available" as including aircraft not owned by licensed carriers but used in air cargo services marketed to the public.

67 Define "international licence" in accordance with new practices such as code-sharing.

67 Correct French wording "actions" to reflect English wording "voting interests."

67(1) Include in the definition of "Canadian" mutual insurance companies recognized as "Canadian" under the *Insurance Companies Act* and investments of nonresident life insurance companies operating in Canada which are made on behalf of their Canadian policy-holders.

68(2) Amend the section to include all prescribed specialty air services now listed in Section 3 of the Air Transportation Regulations.

70(1) Delete the words “order” in the English text and “directive” in the French text as they are unnecessary and imply different meanings.

71 Amend section to prohibit unauthorized “wet leasing” that has the effect of circumventing the Canadian ownership and control requirements.

74 Amend section to allow for transfer of ownership in non-arm’s-length transactions to permit corporate restructuring.

76 Amend the section to eliminate the 120 days notice requirement in regions in the nondesignated area where competitive air service is available; reduce it to 30 days in other regions outside the designated area and in the designated area.

86(1)(d) Amend the section to require the Minister to defend the interests of Canadian carriers from discriminatory user fees and other practices by foreign air carriers and governments.

86 Alternatively, add a new section similar to the current section 156, but applicable to air transportation services.

86 Add a new section to provide for the involvement of the Agency in international organizations engaged in air service regulation where the Agency is a designated aeronautical authority under section 86.

87 Amend section to provide for Agency regulation of re-operation of services via “wet leases.”

90 Amend as in section 74 above.

95 Amend section as in section 74 above.

100(2) Amend section to exclude United States carriers from requirement to have an agent.

102(3) Delete this provision since it is redundant in the face of section 28.

### PART III — RAILWAY TRANSPORTATION

#### Division I

##### Rail Freight

110 Amend definition of "interchange" to include inter-switching rights between carriers operating on the same line of railway.

117(1) Amend the section to shorten the effective period to 20 days.

131 Amend section to require disclosure of revenue division in all cases of joint carriage.

143 Repeal this section in light of experience over the past five years.

148 Amend the section to allow any interested party to apply for running rights.

151 Expand to cover economic and operating disputes respecting such matters as the interchanging of cars and the establishment of revenue divisions between federal and provincial railway companies.

152 Amend section to include interswitching where two railway companies operate on the same line of rail.

152 Amend to provide that an interchange occurs where the service of two rail companies connect, regardless of track ownership, including private sidings with the permission of the owner.

152(3) Amend the section to provide that no interswitching be permitted beyond the 30 kilometre limit, unless interswitching rates are based on commercial reasonableness.

152(5) Amend the section to allow for consideration of commodity and equipment used and offer a more varied rate depending on the number of cars interswitched.

154(7) Clarify track classifications and accord between the English and French texts.

## Division II

### Railway Lines

157(2) Bring the French definition of “costs” into better correspondence with the English definition.

157(4) Abandonment provisions should expressly apply to yard or spur trackage which provides access to interchanges for interswitching purposes.

175(1) Amend to provide that the Minister of Transport may enter into an agreement for the payment of contributions with any interested person or persons and to broaden the circumstances under which the contributions may be made.

## PART V — NORTHERN MARINE RESUPPLY SERVICES

Part V Give the Agency regulatory authority over Marine Atlantic with respect to rates, fares and service levels on other services as well as North Sydney — Port Aux Basques.

**PART VIII — GENERAL AND TRANSITIONAL PROVISIONS  
AND RELATED AND CONSEQUENTIAL AMENDMENTS**

**Division I**

**General and Transitional**

267(3)	Correct the date in the French version to read “le 31 mai” if the annual reviews are to be continued.
269(2)(a)	Amend to provide that subsection 269(1) does not prohibit the communication of information to the “Minister’s agent or representative.”
various	Repeal unnecessary or transitional provisions: 109(1) to (3), 160(7), 171(6), 185(1), 186(2), 198, 200(2), 266 and 272(9).

**MOTOR VEHICLE TRANSPORT ACT, 1987**

2(1)	Define “owner operators” so that they are clearly identified as independent contractors.
7	Split the extraprovincial licence into two parts, specifying a right to international carriage and a right to interprovincial carriage.
MVTA	Provide for the regulation of load brokers with uniform national standards.
MVTA	Remove all administrative duplication. Carriers should only have to deal with one administrative body for all matters related to interprovincial and international operations.
MVTA, Part IV	Provide for the service of summonses on carriers who reside outside of Canada.

**SHIPPING CONFERENCES EXEMPTION ACT, 1987**

2(1)	Amend the definition of “conference” to read “terms and/or conditions.”
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2(1) Amend the definition of “service contract” to permit a shipper to contract a stated proportion of his business to a conference as an alternative to a specified volume.

20 Expand and clarify the nature of the information conferences must supply at meetings with designated shipper groups. The merits of requiring audited financial data should be evaluated.

SCEA Require conference lines to offer multimodal rates on an individual rather than a collective basis.

SCEA Non-Vessel Operating Carriers should be required to file their tariffs with the Agency.

SCEA Independent action on service contracts should be permitted.

#### ***RAILWAY ACT***

79 Amend to eliminate the statutory subordination of railway company debt to statutory penalties due by the railway for noncompliance with the Act, for the purpose of facilitating conveyances to short line operators.

233 This provision regarding the adoption of railway company by-laws is outdated and should be modified to provide the powers now needed by railway companies.

234 Increase penalties for contravention.

291, 292 Amend sections 291 and 292 of the *Railway Act* to treat VIA Rail as other carriers with respect to tariff filings and more particularly to treat VIA as domestic air carriers outside the designated area.

**NON-SPECIFIC SUBMISSIONS****GENERAL**

NTA      Provide for joint federal-provincial dispute-resolution panels where a province includes equivalent provisions in its own legislation. These panels should have authority to deal with all regulatory matters.

*Railway Safety Act*      Amend section 3 of the Guidelines on Apportionment of Costs of Grade Separations to require the allocation of costs in proportion to the benefit accruing to the railway company and the highway authority.



## TERMS AND DEFINITIONS

### Alternate Dispute Resolution

Methods of resolving disputes other than by litigation before courts, including negotiation, mediation and arbitration.

### ASK

Available Seat Kilometres. A measurement of total passenger capacity calculated by multiplying the total number of seats available for sale by the distance flown, as measured in kilometres.

### BASA - Bilateral Air Service Agreement

An international agreement between two countries permitting reciprocal access by national air carriers of each country to serve routes between them. **BASAs** vary widely in the types of permitted passenger routings and connections between and beyond countries.

### Block Space

The sale of tickets en bloc to a tour operator or another airline for part of the seating capacity on aircraft flying particular scheduled routes. The buyer of blocked space generally assumes the financial risk of unsold block space tickets.

### Cabotage

Transport between two or more points in the same country, usually reserved for carriers of that country.

### Capital Cost Allowance

Amounts of depreciation on the various assets of a business which are allowable as deductions when calculating taxable income from a business under

the *Income Tax Act (Canada)*. Capital cost allowances may differ from the depreciation, which may be considered reasonable for the various assets of a business, according to general accounting principles.

### **Captive Shipper**

A shipper that has practical access to only one transport operator, usually a railway, for the carriage of its products.

### **Chicago Convention**

This 1944 multilateral treaty confirmed the basic international law principle that a country has the right to forbid or restrict air carriers incorporated in other countries from carrying passengers or goods into, out of or within that country. As a result, countries have to negotiate access to individual international destinations under **BASAs**. The Chicago Convention also assumes the existence of national air carriers clearly identified with particular countries.

### **CLR — Competitive Line Rate**

A shipper who is more than 30 kilometers from a rail **interchange** may apply to the National Transportation Agency to impose a freight rate on the local rail carrier for movement of the shipper's cargo from the point of loading to an **interchange** with the connecting rail carrier. To apply for a **CLR**, the shipper must first obtain a rate from the connecting carrier for transport from the **interchange** to the final destination.

### **Coasting Trade**

Carriage of goods and passengers by water between port facilities on Canada's coastline.

### **Code Sharing**

The agreed use by one air carrier of the designated alpha code of another air carrier.

**COFC**

Abbreviation for Container On Flat Car.

**Compensatory Rate**

A railway rate which exceeds the **variable cost** of the movement of the goods. If a rate is claimed not to be compensatory, variable cost is determined by the National Transportation Agency.

**Confidential Contract**

A binding written agreement between a shipper and a carrier or carriers establishing the rates and conditions of moving goods, which is to be kept confidential between the parties.

**Conveyance**

A term used in the *NTA, 1987* for the transfer or lease of a railway line from one railway company to another. These transactions are subject to approval by the National Transportation Agency.

**CRS — Computer Reservation System**

A continuously updated computer database maintained at central data processing facilities that contains information about schedules, fares and seat availability of air carriers. These systems are offered by vendors, usually affiliates of air carriers, to subscribers, such as travel agents, through computer networks. A **CRS** subscriber can make reservations, assign seats and issue tickets.

**Designation**

A formal communication from one country to another under a **Bilateral Air Service Agreement**, advising of the selection by one government of an air carrier or carriers to operate routes allowed under the **BASA**.

**Equity Swap**

A reciprocal exchange between corporations of a shareholding interest in each other.

**ERR Program**

Abbreviation for Canada's Economic Regulatory Reform program. One aspect of this program has been to reduce or eliminate the economic regulation of industries, such as transport, where such regulation is considered no longer necessary to meet public policy objectives.

**Extraprovincial Trucking**

Truck transport of goods from a point within a province to another point outside the province, either within or outside Canada.

**Factitious Destination**

To obtain a **Competitive Line Rate**, a shipper must first obtain a rate quotation from a connecting rail carrier which receives the cargo from the local rail carrier. Some shippers have requested rate quotations from connecting carriers for the movement of goods to a point less distant from the point of origin than the ultimate destination intended for such goods. Such a point is known as a **factitious destination**.

**Feeder**

An arrangement used by carriers to transport passengers or goods in smaller numbers or quantities from relatively low volume markets to larger points for onward carriage on higher volume transport routes. For example, a **feeder** can be a spoke in a **Hub and Spoke** distribution system.

**Fitness Test**

A criterion for entry into a regulated transport industry, in which an applicant for an operating licence is required to demonstrate compliance with safety and insurance standards.

**FOA — Final Offer Arbitration**

An **alternate dispute resolution** technique in which the parties to a dispute agree or are required to submit confidential offers of terms to settle the dispute to an arbitrator, who is required to choose one of the offers and not allowed to develop any alternative compromise solution. The rationale for this technique is that the parties to the dispute have an incentive to make reasonable final offers to avoid the risk of the arbitrator's selecting the adverse party's less reasonable offer.

**For-hire Trucker**

A truck operator offering transport services as a common carrier to any person wishing to contract with that operator, as distinct from a private carrier, or a truck operator that has contracted to offer services dedicated to a restricted number of customers.

**Harmonize**

The process of different governments or countries standardizing or making laws, regulations and administrative procedures more compatible, for example, by agreeing to reciprocal recognition of standards or making laws uniform or more similar.

**Hub and Spoke**

As used in the airline industry, this is a route network concept in which a central point (hub) is connected to outlying cities (spokes). Flights between outlying cities are not routed directly between those cities, but rather through the hub. The concept is also used in intermodal transport.

**Hybrid Offence**

A crime defined by statute permitting the Crown to choose to prosecute the offender either by the simplified summary procedure under the *Criminal Code* with lesser penalties, or the more formal indictment with greater procedural rights for the accused and higher penalties.

**Interchange**

A point where a railway line operated by one company connects to another company's trackage, and where railcars can be positioned for **interswitching**.

**Interprovincial Undertaking**

A physical facility, such as a pipeline, which runs between provinces, or a business which provides transport services between two or more provinces.

**Interswitching**

The transfer between railway companies of railcars at an **interchange**. Under the *NTA, 1987*, local railway carriers are required to offer rates to move railcars to connecting rail carriers at an **interchange** within 30 kilometres of the point of origin or destination of traffic.

**Level I Carrier**

A Statistics Canada reporting category for any Canadian air service that in each of the two years preceding that of the report, transported at least one million revenue passengers or at least 200,000 tonnes of revenue earning goods.

**LTL**

Abbreviation for less than truck load, where a shipper contracts for less than the entire cargo carrying space of a truck.

**Operating Ratio**

A standard of financial performance, being the measure of operating expenses as a percentage of operating revenue. An operating ratio of 100 means that operating expenses equal operating revenues.

### **Precarriage**

In intermodal transport, the part of the carriage of goods between the shippers' premises and the first port of loading.

### **Public Interest Test**

The test of establishing that the public interest would or would not be served by a particular occurrence or circumstances, e.g., abandonment of a railway line. The public interest is defined to include the section 3 national transportation policy and any Cabinet or Ministerial directives.

### **Rail Plant**

The physical plant used by a railway operator, including track, bridges and tunnels, signalling systems, and yards.

### **Reverse Onus Test**

The test to be met by a party objecting to the issuance of a licence (e.g., in extraprovincial trucking), on the grounds that granting the licence would be detrimental to the public interest.

### **Running Rights**

Rights obtained by a railway, either through agreement or through application to the National Transportation Agency, to operate its trains over the property of another railway.

### **Slots**

In air transport, the permission granted by a government authority to air carriers to use airspace for landing or taking off from an airport at particular times.

In water transport, cargo carrying space on a ship constructed for carrying containers. Shippers contract for the use of slots in liner services through slot charters.

**Straight Truck**

A truck whose engine, cab and load space are mounted on one chassis, as distinct from a tractor trailer rig.

**Summary Offence**

Criminal conduct which is required by statute to be prosecuted under simplified procedures set out in the *Criminal Code* with lesser jail penalties and without the right to a jury.

**TEU**

Twenty foot equivalent unit. A unit of volume for measuring the carrying capacity of container ships or the amount of container cargo handled by ports. Although originally most shipping containers used in international ocean trade were twenty feet long, the introduction of other container lengths necessitated this common unit of measure.

**TL**

Abbreviation for truckload, where one shipper contracts for use of the entire truck cargo space.

**TOFC**

Abbreviation for **T**railer **O**n **F**lat **C**ar.

**Tonne Kilometre**

An overall measurement of work performed, obtained by multiplying total tonnes of goods by the number of kilometres they are transported.

**Variable Cost**

The variable costs of a railway change with increases or decreases in traffic and include such expenses as train crews and fuel. Fixed costs do not vary with traffic and include such fixtures as tunnels. Several railway cost complexes are partly variable with traffic and partly fixed; e.g., track maintenance

costs increase with traffic, but some of these costs are incurred regardless of traffic levels. The variable costs of railway companies are determined by the National Transportation Agency.

### **Yield**

A measurement of business financial performance. For airline operators, yield generally is the average revenue per **revenue passenger kilometre** or revenue tonne kilometre.





# Order-in-Council

COMPETITION IN TRANSPORTATION

P.C. 1992-176



PRIVY COUNCIL

Certified to be a true copy of a Minute of a Meeting of the Committee of the Privy Council, approved by His Excellency the Governor General on the 31st day of January, 1992

The Committee of the Privy Council, on the recommendation of the Minister of Transport, (hereinafter the Minister) do appoint, pursuant to section 266 of the National Transportation Act, 1987, (hereinafter the Act)

- (1) Gilles Rivard, Quebec City, Quebec as Chairperson, and
- (2) John Gratwick, Halifax, Nova Scotia
- (3) Clay Gilson, Winnipeg, Manitoba
- (4) Frank Collins, Montreal, Quebec
- (5) Horst Sander, Prince George, British Columbia as Members

to carry out and report in both official languages to the Minister on or before January 31, 1993, on a comprehensive review of the operation of the National Transportation Act, 1987, the provisions of the Railway Act amended by the Act, the Shipping Conferences Exemption Act, the Motor Vehicle Transport Act, 1987 and any other Act of Parliament for which the Minister is responsible that pertains to the economic regulation of a mode of transportation.

The Committee do further advise more particularly that the review be an assessment and consideration of the matters set out in subsections 266(2) and 266(3)(a) to (j) of the Act, attached hereto as Schedule A.

...2

- 2 -

The Committee do further advise that:

- (a) pursuant to subsection 266(4) of the Act the persons appointed to carry out the review have, for the purposes of the review, the powers of commissioners under Part I of the Inquiries Act and may engage the services of experts, professionals and other staff deemed necessary for making the review at such rates of remuneration as the Treasury Board approves; and
- (b) the Chairperson is directed to submit the records and papers of the review to the Minister of Transport, as soon as may be possible at the conclusion of the review.

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SCHEDULE A

266. (2) The person or persons conducting the review shall assess the effect of the legislation referred to in subsection (1) on shippers, travellers and carriers and on trade, regions and their economic development and, where necessary or desirable, recommend amendments to

(a) the national transportation policy set out in section 3; and

(b) the legislation referred to in subsection (1).

(3) The following matters shall be considered in connection with any other matters dealt with by the review:

(a) the overall effectiveness of the policy and Acts referred to in subsection (2) in achieving an economic, efficient and adequate network of viable and effective transportation services that are responsive to the needs of shippers and travellers with a minimum of government intervention;

(b) the effect of confidential contracts for the transport of rail freight on shippers and on the efficiency of the rail transportation system in the various regions of Canada;

(c) the advisability and necessity of having a compensatory rate requirement in respect of railway transportation;

(d) the extent to which competitive access to railway transportation has been achieved by shippers in the various regions of Canada;

(e) the impact of this Act on air service in the various regions of Canada, particularly on routes having low traffic volumes;

(f) the advisability of retaining or modifying the special economic regulation applicable to northern and remote areas air services;

- (g) the adequacy and effectiveness of legislation referred to in subsection (1) that pertains to trucking as it affects shippers and carriers;
- (h) the need for retaining, modifying or terminating any or all of
  - (i) the shipping conference practices that are exempt from the Competition Act, or
  - (ii) the terms and conditions pertaining to the exemption referred to in subparagraph (i);
  - (i) the effect on employment and management-labour relations;
  - (j) the effect of sections 134 to 142 on the revenues, financial viability, capital investment and service levels of railway companies.





## SUBMISSIONS

A. Frame Contracting Ltd.  
Air Canada  
Air Transat  
Air Transport Association of Canada  
Alberta Intermodal Services Limited  
Alberta Wheat Pool  
Amalgamated Transit Union – Canadian Council  
Asia North America Eastbound Rate Agreement  
Association des Armateurs du Saint-Laurent Inc.  
Association des Propriétaires d'Autobus du Québec  
Association of International Automobile Manufacturers of Canada  
Atlantic Canada Opportunities Agency  
Atlantic Provinces Transportation Commission  
Auto Haulaway  
Board of Trade of Metropolitan Toronto  
British Columbia Trucking Association  
Brookville Transport Limited  
Brotherhood of Locomotive Engineers  
Brotherhood of Maintenance of Way Employees  
Burlington Northern Railroad  
Canada/Australia-New Zealand Association of Carriers  
Canada Grains Council  
Canada Ports Corporation  
Canada Transpacific Stabilization Agreement  
Canada Westbound Rate Agreement  
Canadian Airlines International Ltd.  
Canadian Association of Railway Suppliers  
Canadian Atlantic Freight Secretariat Ltd.  
Canadian Brotherhood of Railway, Transport & General Workers  
Canadian Bus Association  
Canadian Cement Council  
Canadian Chamber of Commerce  
Canadian Chemical Producers' Association  
Canadian Conference of Moving Organizations  
Canadian Disability Rights Council  
Canadian Fertilizer Institute  
Canadian Human Rights Commission  
Canadian Industrial Transportation League  
Canadian Labour Congress  
Canadian Life and Health Insurance Association  
Canadian Manufacturers' Association  
Canadian National Millers Association  
Canadian National Railways  
Canadian Oilseed Processors Association  
Canadian Paraplegic Association  
Canadian Pulp and Paper Association  
Canadian Railway Labour Association  
Canadian Rehabilitation Council for the Disabled  
Canadian Shipowners Association

Canadian Shippers' Council	Essex County Federation of Agriculture
Canadian Transport Lawyers' Association	
Canadian Trucking Research Institute	Federation of Canadian Municipalities
Canadian Trucking Association	First Air
Canadian Union of Public Employees – Airline Division	Fletcher Challenge Canada
Canadian Wheat Board	Fording Coal Limited
Canamera Foods	
Carrier Consulting Services Inc.	Gouvernement du Québec – Ministère des Transports
CAW – Canada	Government of Alberta – Department of Transportation and Utilities
Central Western Railway Corporation	Government of British Columbia – Department of Transportation and Highways
Century Freight	Government of Manitoba – Department of Highways and Transportation
Chamber of Shipping of British Columbia	Government of New Brunswick – Department of Transportation
Coal Association of Canada	Government of Newfoundland and Labrador – Department of Works, Services and Transportation
Coalition of Concerned Shippers	Government of Nova Scotia – Department of Transportation and Communications
Coalition of Provincial Organizations of the Handicapped	Government of Ontario – Ministry of Consumer and Commercial Relations
Conseil Régional de Concertation et de Développement de la Gaspésie et des Iles-de-la-Madeleine	Government of Ontario – Ministry of Transportation
Conseil Régional de Développement de l'Abitibi-Témiscamingue	Government of Prince Edward Island – Department of Transportation and Public Works
Consumer and Corporate Affairs – Bureau of Competition Policy	Government of Saskatchewan – Department of Highways and Transportation
Cooper Barging Service Limited	Government of the Northwest Territories – Department of Transportation
Corporation of the County of Kent	
Council of Forest Industries of British Columbia	
Council of Maritime Affairs	
CP Rail	
CSX Transportation Inc.	
Department of Western Economic Diversification	
Ducks Unlimited Canada	
East Canada Caribbean Rate Association / East Canada South American Rate Agreement (ECSA)	

Government of the Yukon – Department of Community and Transportation Services	Northern Transportation Company Limited
Greater Charlottetown Area Chamber of Commerce (Transportation Committee)	Novacor Chemicals Ltd. Novacor Chemicals Ltd. (Methanol Division)
Halifax Board of Trade	Oceanex
Halifax Port Corporation	Ontario Corn Producers' Association
Halifax-Dartmouth Port Development Commission	Ontario Grain and Feed Dealers Association
Imperial Oil	Ontario Motor Coach Association
Industry Advisory Group	Ontario Soybean Growers' Marketing Board
Inland Cement Limited	Ontario Wheat Producers' Marketing Board
Integrated Employment Consulting Services	PCS Sales
International Association of Machinists and Aerospace Workers	Peacock's Yukon Camps Ltd.
Jetall	Pertama-Tentar Inc.
Kent County Federation of Agriculture	Prince Rupert Port Corporation
Lacaille, Georgette	Procter & Gamble
Lafarge Canada Inc.	Propane Gas Association of Canada Inc
Luscar Limited	Railway Association of Canada
Manalta Coal Ltd.	Regional Municipality of Ottawa- Carleton
Manitoba Pool Elevators	Saskatchewan Wheat Pool
Matheson, Rand H.	Saskpower
Motor Carrier Commission, British Columbia	Sharwood and Company
Motor Vehicle Manufacturers' Association	Shell Canada Products Limited
National Transportation Agency of Canada	Shipping Federation of Canada
Neptune Bulk Terminals (Canada) Limited	Société du Port de Québec
NKK Corporation	Southern Rails Cooperative Limited
	St. Lawrence Seaway Authority
	Stephenville Chamber of Commerce
	Table de Concertation sur l'Industrie Ferroviaire
	Teamsters Local No. 938

COMPETITION IN TRANSPORTATION

Thunder Bay Harbour Commission  
Topnotch Feeds Ltd.  
Transport 2000 Ontario  
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